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CORPORATE PARTICIPANTS

Julie LaFollette *American Equity Investment Life Holding Company - Director of IR*

John Matovina *American Equity Investment Life Holding Company - Chairman, President & CEO*

Ted Johnson *American Equity Investment Life Holding Company - CFO & Treasurer*

Ron Grensteiner *American Equity Investment Life Holding Company - President, American Equity Life Insurance Company*

Jeff Lorenzen *American Equity Investment Life Holding Company - EVP & Chief Investment Officer*

CONFERENCE CALL PARTICIPANTS

Randy Binner *B. Riley FBR - Analyst*

Ryan Krueger *Keefe, Bruyette & Woods - Analyst*

John Barnidge *Sandler O'Neill & Partners - Analyst*

Dan Bergman *Citigroup - Analyst*

Erik Bass *Autonomous Research - Analyst*

Pablo Singzon *JPMorgan - Analyst*

Greg Peters *Raymond James - Analyst*

Alex Scott *Goldman Sachs - Analyst*

Mark Hughes *SunTrust Robinson Humphrey - Analyst*

John Nadel *UBS - Analyst*

PRESENTATION

Operator

Welcome to American Equity Investment Life Holding Company's second-quarter 2018 conference call. At this time for opening remarks and introductions I would like to turn the call over to Julie LaFollette, Director of Investor Relations.

Julie LaFollette - *American Equity Investment Life Holding Company - Director of IR*

Good morning and welcome to American Equity Investment Life Holding Company's conference call to discuss second-quarter 2018 earnings. Our earnings release and financial supplement can be found on our website at www.american-equity.com. Non-GAAP financial measures discussed on today's call and reconciliations of non-GAAP financial measures to the most comparable GAAP measures can be found in those documents.

Presenting on today's call are John Matovina, Chief Executive Officer; Ted Johnson, Chief Financial Officer; and Ron Grensteiner, President of American Equity Investment Life Insurance Company.

Some of the comments made during this call may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act. There are a number of risks and uncertainties that could cause actual results to differ materially from those expressed or implied. Factors that could cause the actual results to differ materially are discussed in detail in our most recent filings with the SEC.

An audio replay will be made available on our website shortly after today's call. It is now my pleasure to introduce John Matovina.

John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

Thank you, Julie. Good morning, everyone, and thank you for joining us this morning. American Equity's second-quarter non-GAAP operating income of $86.6 million or $0.95 per share was up 12% sequentially, largely on the strength of an increase in certain non-trendable investment spread items. We also initiated an investment realignment program in the quarter that had a modest impact on second-quarter results and is expected to have a more meaningful impact on our investment spread in future quarters.

Now, as a reminder, the three key metrics that drive our financial performance are: growing our invested assets and policyholder funds under management; generating a high level of operating earnings on the growing assetbase through investment spread; and minimizing impairment losses in our investment portfolio.

For the second quarter of 2018, we delivered 1.6% sequential growth and 6.4% trailing 12-month growth in policyholder funds under management. On a trailing 12-months basis, we generated a 14.2% non-GAAP operating return on average equity, and that excludes the impact of actuarial assumption reviews and loss on extinguishment of debt. And then excluding the interest rate-related losses from the investment realignment program, our investment impairment losses, after the effects of DAC and income taxes, were just 6 basis points of average equity.

The growth in policyholder funds under management for the quarter was driven by a $1.2 billion of gross sales. That's a 17% sequential increase. Fixed index annuity premiums were up 13% sequentially in the second quarter. The IncomeShield 10 guaranteed lifetime income product that we launched in March has been well received and we expect to launch new accumulation products in the American Equity and Eagle Life distribution channels later this quarter. You'll hear more about the sales environment and competition from Ron.

So while the sequential increase in investment spread in the second quarter primarily reflected an increase of 8 basis points in the benefit from fee income, from bond transactions, pre-payment income and over hedging, we also realized some benefit from higher yields on our invested assets and reductions in renewal rates that began in March. We expect to realize additional benefit from the realignment of invested assets and are considering further renewal rate actions. Ted will have more details on investment spread in his remarks.

Substantially all of the realized losses on investments for the second quarter were interest raterelated losses on securities sold as part of a program to opportunistically replace lower yielding securities with higher yielding securities. Our low level of investment impairment losses once again reflects our continuing commitment to a high-quality investment portfolio.

I'll be back at the end of the call for some closing remarks, but now I'd like to turn the call over to Ted Johnson for additional comments on secondquarter financial results.

Ted Johnson - *American Equity Investment Life Holding Company - CFO & Treasurer*

Thank you, John. As John said, we had non-GAAP operating income of $86.6 million or $0.95 per share for the second quarter of 2018. This compares quite favorably to non-GAAP operating income of $63.7 million or $0.71 per share for the second quarter of 2017, with much of the increase related to lower statutory federal income tax rate in 2018. On a pre-tax basis, second-quarter 2018 non-GAAP operating income was up 13% over the prior year's second quarter.

Investment spread for the second quarter was 264 basis points, up 10 basis points from the first quarter of 2018, as a result of an 11 basis point increase in the average yield on invested assets compared to just a 1 basis point increase in the cost of money.

Average yield on invested assets was 4.47% in the second quarter compared to 4.36% in the first quarter. The increase in the average yield in the quarter reflected a benefit from non-trendable investment income items of 10 basis points, including 7 basis points from pre-payment and fee income, compared to just 3 basis points from such items in the first quarter.

The average yield on fixed income securities purchased and commercial mortgage loans funded in the second quarter was 4.77% compared to 4.43% in the first quarter of 2018. The yield on investments purchased or funded in July was 4.89%. With the continued increase in the benchmark

10-year US Treasury rate and rates available on the asset classes we have targeted for purchase, we are finally seeing a long trend of declining average yield on invested assets begin to reverse.

We continue to benefit from the deployment of money into asset classes not traditionally in our portfolio. We have continued the higher allocations to asset-backed securities such as collateralized loan obligations and are looking to increase allocations to commercial mortgage loans. We also began adding infrastructure securities loans to the portfolio and, consistent with our past practice when we diversify into an unfamiliar asset class, have contracted with an experienced manager to assist us with this asset class. We do not expect to take on material increase in credit risk with this allocation strategy, but there will be a slight increase in investments with an [NAIC 3] designation. NAIC 3 investments were 2.8% of fixed maturity securities at June 30 compared to 2.5% at December 31, 2017.

The addition of CLOs in certain commercial mortgage loans to our portfolio has positioned us to have a portion of the portfolio benefit from increases in short-term interest rates. At June 30, we had $3.3 billion or 7% of our investment portfolio in floating rate investments. We expect our allocation to floating rate investments to increase to roughly 8% of our investment portfolio by the end of the year. We estimate we realized 2 basis points of additional investment yield in the second quarter from increases in rates from our floating-rate portfolio.

As mentioned during our first-quarter conference call, we are looking to improve our investment yield through opportunistic replacement of lower yielding securities with higher-yielding securities. During the second quarter, we sold $1.6 billion in book value of securities with an average yield of 3.12%. As book yields on the securities sold were less than market yields, we incurred a capital loss of approximately $38 million on the sales. This loss should be recovered from the higher yields on the securities acquired with the proceeds from the sales in less than two years. While the substantial sale of lower yielding securities together with the annuity deposits received during the quarter left us with a short-term cash position of $604 million at June 30, we anticipate we will pick up incremental investment yield from additional portfolio realignment once the June 30 excess cash position is invested.

The aggregate cost of money for annuity liabilities was 183 basis points, up 1 basis point from the first quarter of 2018. That benefit from over hedging index linked interest obligations was 6 basis points in the second quarter compared to 2 basis points in the first quarter. The 5 basis point increase in the cost of money, excluding over hedging benefits, primarily reflects the escalation of option costs for certain index strategies in the last several quarters that is recognized in the cost of money ratably over the 12-month option period.

As we stated on our first-quarter earnings conference call, to counteract this impact, we began lowering caps for the monthly point-to-point index strategy in March. We are also raising spreads for our volatility controlled index strategy. Total policyholder funds affected is $11.4 billion and we expect annual savings of nearly 28 basis points on the $11.4 billion once all rate changes are implemented. This is roughly 6 basis points on the entire in-force. As John mentioned, we will be considering additional renewal rate adjustments this quarter.

One trend affecting quarterly spread comparisons is a change in the product mix from bonus products to non-bonus products, which include the American Equity Choice and Eagle Select products. Non-bonus products have a lower spread requirement than bonus products, which translates into a higher cost of money for non-bonus products. The estimated impact from this change on the second-quarter sequential spread income was modest at 1 basis point, but this is a trend we expect will continue in future quarters.

We continue to have flexibility to reduce our crediting rates if necessary, and could decrease our cost of money by approximately 59 basis points if we reduce current rates to guaranteed minimums. This is up from 54 basis points at the end of March.

Our effective income tax rate on non-GAAP operating income in the quarter was 20.5%. Income tax expense in the quarter was reduced by $842,000 from the income tax benefit for share-based compensation. The benefit varies from quarter to quarter based on stock option exercise activity and the vesting of restricted stock and restricted stock units. The effective income tax rate excluding this item was 21.4%. We continue to expect our non-GAAP operating ineffective income tax rate to be in a range of 20% to 22%.

Our estimated risk-based capital ratio at June 30 was 384%, up from 378% at December 31, 2017. Now I'll turn the call over to Ron to discuss sales, marketing and competition.

Ron Grensteiner - *American Equity Investment Life Holding Company - President, American Equity Life Insurance Company*

Thank you, Ted. Good morning, everyone.

As we reported yesterday, gross sales for the second quarter of 2018 were $1.2 billion, up 17% compared to the first quarter of 2018. This is the third consecutive quarter that we reported higher sales sequentially.

Fixed index annuity sales increased 13% sequentially, reflecting a 14% increase at American Equity Life and an 8% increase at Eagle Life. The fixed index annuity market remained competitive in the second quarter with a number of competitors raising caps, participation rates and guaranteed lifetime income.

Reflecting the attractiveness of accumulation products in the current market environment, the Choice Series continues to be our best selling product line at American Equity Life with 37% of sales in the second quarter. This compares to 35% in the first quarter of 2018 and 33% in the fourth quarter of 2017. Choice 10 remained our best-selling product in the second quarter.

Guaranteed lifetime income has been a significant focus for us through the years and we're thrilled with the initial reception of the IncomeShield series by our independent agents. As a reminder, the IncomeShield series was introduced on March 19 to improve our competitive positioning in the guaranteed lifetime income space. Guaranteed lifetime income on IncomeShield is competitive with levels offered by our most important competitors, despite having annual fees which are among the lowest in the industry. The no-fee rider option has proven very attractive to distribution as well.

IncomeShield is already our second best-selling product line, accounting for 23% of American Equity Life sales in June. While many of our agents have pivoted from one of our other products to IncomeShield, we believe we have picked up incremental sales from agents who have returned to selling American equity products after selling products for our competitors.

Later this quarter, we plan to introduce a new series of non-bonus products focused on accumulation and sold without a lifetime income benefit rider. A key feature will be a participation rate above 100% on the S&P 500 Dividend Aristocrat Excess Return Index. In addition, these products will have a first of its kind crediting strategy based on the S&P 500 index.

We expect this new strategy to compare favorably to the monthly point-to-point strategy that has been popular in fixed index annuities for more than 10 years. These indexing strategies, together with our traditional participation rate strategy on the S&P 500 index, should compete very well with the hybrid index/multi-term products which certain distributors have focused on. The new product series will be available with 5-, 7-, and 10-year surrender charge periods.

While these products featuring hybrid strategies remain popular in the marketplace, we continue to have no interest in introducing a new index with no absolute performance history created solely for the purpose of being used in a fixed index annuity. We believe such indices add little to no benefit to policyholders compared to traditional S&P 500 index products and increase complexity.

Turning to pending, pending business at American Equity Life averaged 2,640 applications during the second quarter and was 2,598 at the end of June compared to 2,696 applications when we first reported first-quarter 2018 earnings. Pending applications stand at 2,341 as of this morning. One year ago, pending was 2,048.

As I said earlier, Eagle Life's index annuity sales were up 8% sequentially. Keeping our participation rates competitive was certainly a factor. Also, an increase in our multi-year fixed annuity rates opened some doors to promote our fixed index annuities. One of our newly recruited mid-major banks gained some sales traction and our employee wholesalers are also making a difference in a large financial institution previously serviced by a third-party wholesaler. Pending at Eagle Life stands at 263 applications today compared to 239 when we reported first-quarter earnings. Participation rates on our Eagle Select series remain attractive.

Fixed index annuities with surrender charge periods shorter than six years have become popular in the bank and broker-dealer channels. To meet this demand, Eagle Life recently introduced a fixed index annuity with a five-year surrender charge period, Eagle Select Focus 5. In addition to the traditional Select Series features, this product uses the same S&P 500 Dividend Aristocrat Index strategy that I mentioned while discussing the new accumulation product series at American Equity Life. The Select Focus 5 features an annual participation rate of 120% on this index with a market value adjustment rider added. A seven-year product, the Eagle Select 7, or Focus 7, will be introduced later this quarter with the same index strategies as the Select Focus 5. We will retain 100% off all Select Focus 5 and 7 sales. With Eagle Select 6, 8, and 10 and now the select Focus 5 and 7, Eagle Life will have a robust product portfolio incorporating various surrender charge periods, indexing strategies and compensation structures.

Finally, later this month, Eagle Life anticipates beginning a new sales effort through one of the country's 15 largest banks based on assets. Our products look competitive and we will, at least at the time of introduction, have the only participation rate strategy in its system. And with that I'll turn the call back over to John.

John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

Thank you, Ted and Ron. We are certainly pleased with our second-quarter results and the outlook for the next several quarters. The first-quarter sales momentum at American Equity Life did continue well into the second quarter; our IncomeShield series has been well received by our independent agent distribution; and we have several new products and we expect to roll out this quarter. On the spread side, the prospect for higher investment yields is quite good and the trend of declining investment yields that has persisted for more than eight years has likely abated. Option costs do remain a challenge but, as always, we will take the necessary actions to protect our spread and we have ample room to lower caps, participation rates and crediting rates on our in-force business.

With the Department of Labor's fiduciary rule formally vacated by the Fifth Circuit Court of Appeals, we continue to participate in the National Association of Insurance Commissioner's review of the model suitability law and to monitor the Securities and Exchange Commission's work on its best interest standard. The SEC comment period ends today and the NAIC working group met last week to continue work on possible changes to the model suitability law.

Our long-term outlook remains favorable as the aging American population needs products like fixed index annuities that build retirement savings with low volatility of returns while offering options for guaranteed lifetime income. American Equity has been a significant participant in the fixed index annuity market and we are fully prepared to participate in the growth that we see ahead for our market. The value proposition we have always offered in our distribution partners -- transparent products, attractive renewal crediting history, and unparalleled service -- remains as attractive as ever.

Now before we move to Q&A, I want to advise everyone that we will not be commenting on or answering any questions about market rumors or a potential transaction. So, on behalf of the entire American Equity team, thank you for your time and attention this morning and we'll now turn the call back to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Randy Binner, B. Riley.

Randy Binner - *B. Riley FBR - Analyst*

On the investment strategy, I had a couple. One was that you mentioned you were going to try to allocate 8% of the portfolio to floating-rate securities by yearend 2018. And so I just want to confirm that's the case. And then beyond that, if that would continue to be a higher proportion of the portfolio and what proportion of that would be.

And then you mentioned CDO, CRE loans and structured securities. I guess these are privately negotiated generally, maybe with the exception of some CDOs. So is it -- the attraction there, it's higher yield, so there is greater risk. So, could you dimension out if structure and kind of privately placed stuff is mitigating some of that risk of just taking high yields?

Jeff Lorenzen - *American Equity Investment Life Holding Company - EVP & Chief Investment Officer*

Yes Randy, it's Jeff Lorenzen. On the topic of the CLOs -- and not CDOs, but CLOs -- most of ours are going to be publicly generated securities, so we're not going necessarily to the private market. These are transactions that have plenty of liquidity and offer very good attractive values in terms of market comparisons.

In terms of the floating rate component of the portfolio, we initially targeted 8%. We'll see where the market opportunities go. It depends on what Fed policy continues to look like as we move through our strategy.

If we get to the point where we still believe that there is potential upside for more Fed action then we may continue to move that a little bit higher. If we feel like we're capping out and we don't see we're going to get a lot of incremental benefit from the floating-rate component of it, it may be something that we cap out and we maintain our position.

Randy Binner - *B. Riley FBR - Analyst*

Okay, that's helpful. And then I guess the follow-up just is the RBC ratio impact of all of that activity. You mentioned there being lower Level 3 investments. If there are some new proposed rules too for how mezza assets are classified within the RBC construct. So I guess that net of it is, is there a tolerance of RBC you'd be willing to lose on a percentage basis to gain the advantage of a better placed portfolio?

Jeff Lorenzen - *American Equity Investment Life Holding Company - EVP & Chief Investment Officer*

Well, what we've seen so far for the portfolio realignment is the impact from RBC has been fairly minimal. So that isn't overly restrictive for us. Jumping to the other topic, changing of factors and what the NAIC is looking at, when we run and look at what their interim factors that they've put at, we're at 384 now. We would see maybe our RBC go to 357.

But again, from -- that is purely an NAIC calculation and doesn't necessarily affect how the rating agencies look at that. So we're not necessarily overly concerned on that. But so far in regards to the realignment and what we've done, the impact to RBC has been fairly minimal.

Randy Binner - *B. Riley FBR - Analyst*

Okay. And still managing 350 would be the floor (multiple speakers) right? Or you would go lower with the new standard?

Jeff Lorenzen - *American Equity Investment Life Holding Company - EVP & Chief Investment Officer*

No. Our target is we're trying to manage between 375 and 400.

Randy Binner - *B. Riley FBR - Analyst*

Well, I guess (multiple speakers).

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John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

Under the current framework.

Jeff Lorenzen - *American Equity Investment Life Holding Company - EVP & Chief Investment Officer*

Under the current framework of what the NAIC is is we're managing between 375 and 400. And remember, Randy, why we're targeting that, too, is looking at where our ratings are at with the various rating agencies. And one of the rating agencies that we would like to obtain an upgrade from is Fitch. And they have referenced they would like us to have a 375 RBC and maintain that, or higher.

Randy Binner - *B. Riley FBR - Analyst*

Okay. So the net of it is you don't have a lot of wiggle room on RBC ratio to accommodate significant net risk increase in the portfolio. So if (multiple speakers) these changes would affect that.

Jeff Lorenzen - *American Equity Investment Life Holding Company - EVP & Chief Investment Officer*

Well, we're at 384, and I think we've said before that if you looked at what our capacity would be for sales, we could produce up to $6 million and our RBC ratio should stay fairly level. So, we're in a situation where we're -- while we're doing some of this realignment, we're also building up RBC because we're putting less of that capital to work through sales. So we do have some flexibility here in what we're doing right now.

John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

In addition, Randy, we haven't seen a credit quality decrease in our portfolio as part of this realignment. It's just an asset class shift where we're going in -- we're going out of very high quality -- or maybe BBB rated corporates that have rolled down the curve that have a lower yield and going out that curve a little bit and going into a different asset class -- that has higher yield. So overall (multiple speakers) our credit quality of our portfolio has actually remained the same: it's A rated.

Randy Binner - *B. Riley FBR - Analyst*

Understood, thank you.

Operator

Ryan Krueger, KBW.

Ryan Krueger - *Keefe, Bruyette & Woods - Analyst*

I just had a follow-up on the asset realignment. Can you give us a broad sense of how much additional assets you might consider for realignment from here?

John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

At this point in time we have some capacity left to -- within the framework of what we're working with, to continue. Our target is to get a couple hundred million more done in the near-term. And then we'll reevaluate as we get into the fourth quarter and determine where we are positioned longer-term for how we want to shift the portfolio and add incremental yield. But we do have some shelf space left to do some further realignment.

Ryan Krueger - *Keefe, Bruyette & Woods - Analyst*

Thanks. Operating expenses have increased some this year to 26 basis points of account value. I think they typically run around 24 basis points. Is that something you'd expect to continue at a similar level as the first half going forward?

Ted Johnson - *American Equity Investment Life Holding Company - CFO & Treasurer*

I mean, I think our operating expenses that we have is pretty close to probably what our run rate would be. We certainly have seen incremental increases, mostly in salaries and benefits, just due to adding additional employees to the workforce because of the growth we have here at the Company.

Ryan Krueger - *Keefe, Bruyette & Woods - Analyst*

Thanks. And then just last one. I may have missed this, but did you provide the American equity average pending count for the second quarter? And if not, could you provide that?

Jeff Lorenzen - *American Equity Investment Life Holding Company - EVP & Chief Investment Officer*

Yes, the -- let's see.

John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

2,640 was the average for Q2.

Ryan Krueger - *Keefe, Bruyette & Woods - Analyst*

Great, thank you.

Operator

John Barnidge, Sandler O'Neill.

John Barnidge - *Sandler O'Neill & Partners - Analyst*

MYGA activity picked up, the highest since early 2016. Are you trying to get more into bank and broker/dealers now obviously? But is it because of DoL headwinds going away and thus broker/dealers are looking to expand their products again?

Ron Grensteiner - *American Equity Investment Life Holding Company - President, American Equity Life Insurance Company*

No, it's more of the former. We felt that we needed to raise our MYGA rates a bit at Eagle Life just so we could be in the conversation with the different financial institutions and have more conversations about our fixed indexed annuities in the process.

John Barnidge - *Sandler O'Neill & Partners - Analyst*

Okay. And then another question. What are your thoughts on New York State recently proposing a best interest regulation? Do you think other states will pick up? And what can the industry do to push back, because it was successful in the DoL pushing back. Thanks for the answers.

John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

Well, relative to New York, it's going to have pretty much no impact on us. We're not active in the state of New York. And the -- I know that, for instance, on the cyber security, the playbook seemed to be New York did something and the NAIC fell in line. I think we would be surprised if we saw the same playbook this time around, that the rest of the states and the NAIC gravitate [to door] what New York has already adopted.

And I know the model suitability, there was -- the working group was meeting over the weekend, I guess. The NAIC had its quarterly meeting, I think starting Saturday through yesterday. But I don't think there's any momentum for the NAIC to pick up on what New York has already adopted.

John Barnidge - *Sandler O'Neill & Partners - Analyst*

Great, thank you.

Operator

Dan Bergman, Citi.

Dan Bergman - *Citigroup - Analyst*

(Technical difficulty) actions increased nicely this quarter and came in at least higher than I had expected. So I was hoping you could provide a little color on what you saw in the quarter and what drove the sequential increase. And just given the recent rise in interest rates, any thoughts on how we should expect prepayments to trend ahead?

Ted Johnson - *American Equity Investment Life Holding Company - CFO & Treasurer*

Dan, can you restate that question? You didn't come through in the very beginning.

Dan Bergman - *Citigroup - Analyst*

Sure, sorry about that. Hopefully this is better. So just in terms of prepayments and bond transactions, with the sequential increase we saw this quarter, I just wanted to see if you could give a little bit more color on what you saw in the quarter and what drove that increase. And then just going forward, given the rise in interest rates, how we would expect -- we should expect prepayments to trend going forward?

Ted Johnson - *American Equity Investment Life Holding Company - CFO & Treasurer*

Again, I'll give a little bit of the breakout and Jeff can talk about trends, which I'll say right away are very hard to predict on what the trend will be on prepayments and other types of non-trendable investment income.

So we talked about 10 basis points this quarter of non-trendable related to investment income, 7 of that is additional prepayment income related to bond calls or prepayments on mortgage loans. And then there's 3 basis points that's related to primarily RMBS security paydowns and some other non-trendable items. So with that, I'll let Jeff try to answer the trend question.

Jeff Lorenzen - *American Equity Investment Life Holding Company - EVP & Chief Investment Officer*

One of the trends, you know if you -- as we look at the RMBS side of it, we haven't purchased any new RMBS for quite a few time. We have a lot of what I'd call seasoned paper in the portfolio that probably still has fairly high coupons back from 2008, 2009, even before then.

So even modest increases in interest rates really probably aren't going to have a dramatic impact on slowing those down. And I think we're going to see quarters where maybe you have a little bit of higher prepayment, maybe the quarter prior was a little bit softer. But on average were going to probably continue to see that trend move forward, even if we see interest rates move up a little bit more from here.

Dan Bergman - *Citigroup - Analyst*

Got it. That's very helpful, thank you. And then maybe just one on the cost of crediting. And I saw the -- excluding the over-hedging, I know the cost of money moved up due to the elevated option cost, and I know you've taken some renewal rate adjustments earlier in the year. But I just wanted to see if you could give some guidance in terms of the timing or how soon those actions will begin to impact the cost of money and just generally how we might expect that to trend going forward?

Ted Johnson - *American Equity Investment Life Holding Company - CFO & Treasurer*

Well, we have the decisions that have been made or are in place on the $11.4 billion, which had started in March. And overall that should affect the cost of money in total by 6 basis points. That isn't necessarily going to trend in ratably over the 12- to 15-month period of time, but it will come through 1 bp to 2 bps a quarter.

Now, the remaining piece is, as we have stated, we are looking at renewal rates and will be deciding on whether or not we'll make adjustments to those here in the near-term, but we have not made those decisions yet.

And again, any decision we would make on any renewal rate adjustments down would then start flowing in over a 12- to 15-month period of time. And so there would be a lag of the decrease and what we would see in our cost of money compared to the increases that we already experienced and are experiencing.

Dan Bergman - *Citigroup - Analyst*

Got it. That's very helpful, thank you.

Operator

Erik Bass, Autonomous Research.

Erik Bass - *Autonomous Research - Analyst*

And I appreciate that you're unable to talk about any potential transactions, but just can you discuss why you chose to put out a release confirming preliminary discussions?

John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

Well, it's been so long ago I forgot all the discussions that we were having as to why.

Ted Johnson - *American Equity Investment Life Holding Company - CFO & Treasurer*

That was in response to a market rumor or an article that had been published.

Erik Bass - *Autonomous Research - Analyst*

Okay. So just responding specifically to that market rumor?

Ted Johnson - *American Equity Investment Life Holding Company - CFO & Treasurer*

Yes.

John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

Yes.

Erik Bass - *Autonomous Research - Analyst*

Okay. And then, I guess Jeff or Ted, if you could comment -- just to make sure I have the moving pieces on the investment realignment correct. You talked about initially there being some cash drag. Would you see that as something that could negatively affect the spread in the third quarter and then you would certainly benefit from reinvesting at higher yields beyond that? Or would you expect the reinvestment to fully offset in the third quarter?

Ted Johnson - *American Equity Investment Life Holding Company - CFO & Treasurer*

There's going to be a slight amount of drag that we'll see in the quarter, but we expect that, based upon purchases -- forward purchases that we have out there for August, that we should be able to absorb that excess cash balance.

Erik Bass - *Autonomous Research - Analyst*

Got it, thank you. And then finally for Ron, if you could just talk a little bit more about the competitive environment in the different distribution channels and how you expect the new product introductions you talked about to improve your market position.

Ron Grensteiner - *American Equity Investment Life Holding Company - President, American Equity Life Insurance Company*

Well, it's been -- I'd say the competition has been more intense than usual, particularly in the guaranteed income market. Kind of seeing a -- almost a one-upmanship by some of our competitors where they'll raise guaranteed income and then another competitor will leapfrog over them. So it's really been fierce, again, particularly in the guaranteed income.

We think our guaranteed income is competitive but -- and we can match up fairly well against them. We're not the highest but our value proposition has always been let's be competitive and let's fill the gap with our excellent customer service, answering the phone in 60 seconds and issuing policies in 24 hours and those types of things.

On the bank side, everybody is competitive. In particular the cap rates on the S&P 500 are -- there is a lot of them that are over 6% now. Actually there's 21 carriers with 74 different products that have caps of 6% or higher.

We are very competitive in the participation rate strategy. We have -- on a pure S&P annual point-to-point strategy, we have about the highest if not the highest, and that tends to be our lane. So, we're optimistic for sales but it is very, very competitive.

Erik Bass - *Autonomous Research - Analyst*

Thank you. That's helpful color.

Operator

Pablo Singzon, JPMorgan.

Pablo Singzon - *JPMorgan - Analyst*

Can you please talk about your most recent option costs on policy renewals? I think in 1Q you were slightly north of 190 bps. Is that still the case? And your (inaudible) cost of money is 189 bps, and it seems like the gap versus the cost of option renewals has narrowed significantly at least versus 2017 when the cost was I think about 180 bps.

Ted Johnson - *American Equity Investment Life Holding Company - CFO & Treasurer*

In regards to option cost of money, we're still experiencing option costs in those low 190s.

Pablo Singzon - *JPMorgan - Analyst*

Okay. But just given where just the cost is right now, which is 189, I guess the [transduction would] be as steep as what we saw from 2017 to this year, correct?

Ted Johnson - *American Equity Investment Life Holding Company - CFO & Treasurer*

I'd have to think about that, Pablo, more to really be able to answer that. It's going to be dependent, too, replacing option costs. Back in the beginning, four quarters ago, were quite a bit lower. They were in maybe the 170 range, so you are replacing option costs four quarters ago that were 170 now with options that are costing on average 192, 190.

Pablo Singzon - *JPMorgan - Analyst*

Okay. And then my next question was as you are reshaping the investment portfolio, would you ever consider investing in alternative type assets that generate closer to high single digit returns, like some of your [fee back] peers are doing? If so, why or why not? And is capital a constraint as you're thinking about doing something like that potentially?

John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

Yes, it's definitely something that we're considering. And historically when we've had a lower RBC it hasn't been something where we wanted to allocate capital at risk to the portfolio. But as we accumulate more capital, it gives us more flexibility to maneuver the portfolio into asset classes maybe we traditionally haven't looked at.

We're clearly looking at alternative strategies for the portfolio that align with our philosophy of high quality portfolio and protecting the downside. And we have several things that we think are interesting that we think could fit in the portfolio over the long-term.

Pablo Singzon - *JPMorgan - Analyst*

And do you have a (multiple speakers) -- sorry, go ahead.

John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

Pablo, excuse me, it would be a big stretch for us to get allocations and alternatives that get anywhere near what some of our competitors have.

Pablo Singzon - *JPMorgan - Analyst*

Sure. But do you have a sense of -- maybe at what capital level would you start dipping your toes in those kinds of assets?

Ted Johnson - *American Equity Investment Life Holding Company - CFO & Treasurer*

Yes, I think at any point in time we can dip our toes. We only have about $150 million at this point in time that we would consider to be alternatives, so we've got plenty of flexibility in terms of capital at risk. It's finding the right partners; it's not stuff that we would -- it's not investments we would do in-house.

We're finding the right partners and the right types of assets live help diversify the portfolio that are non-correlated to our credit risk in our portfolio and allow us to reduce overall risk in the portfolio as we look at it from a macro standpoint.

Pablo Singzon - *JPMorgan - Analyst*

Okay, thanks.

Operator

Greg Peters, Raymond James.

Greg Peters - *Raymond James - Analyst*

Obviously the market rumor press release is off the table for questions. So I thought I'd focus on the sales. And if you look at your market share since 2015, I think it's been trending down. And I think, Ron, you provided some color around products, etc., and how you think you are positioned for the second quarter. But to tie this up with the market rumor, do you think that's having any effect on sales results when you talk to your agents?

John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

Greg, this is John Matovina. And yes, sales outcomes are always difficult to pinpoint the reasons or expectations, but certainly -- and as Ron has talked about, the competitive dynamic has been there throughout the year. But yes, there is feedback coming from our distribution that says the market rumors are influencing their activities.

And so, putting a number on that is very impractical to do, but certainly we're catching that feedback from agents. And in some cases, most recently there was a pretty substantial agent, a guy who's been in the top 10, who shared with us that his business for the time being was off with us because he was concerned about the outcome.

Greg Peters - *Raymond James - Analyst*

So, okay, thank you for that answer, John. Switching gears, one of your competitors reported -- and I think I mentioned this to you earlier, that there was -- one of your competitors reported an unlocking charge in the second quarter and -- due to higher option costs and interest rates. And I'm curious -- your review I believe is in the third quarter, but maybe you could provide some color around your perspective with the higher costs that you've discussed in this call.

Jeff Lorenzen - *American Equity Investment Life Holding Company - EVP & Chief Investment Officer*

Certainly from an unlocking perspective, part of the reason -- I mean, we'll be looking at what we think and expected spread will be out into the future. And that would be obviously one of the reasons why we're currently looking at renewal rates.

We certainly have made progress on investment yield, as we've talked about today, and we expect to hopefully make further progress on that. But we're also considering being able to manage our spread and where we would like to be through renewal rate actions.

John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

Greg, one addition to that, too. I mean their observation was -- seemed to be focused on costs only. And Ted's comments to you were our focus was on the spread, so -- because to us, just an increase in option cost is not automatic that there's going to be an unlocking. Because obviously it's the spread number that fits [EGP], so --

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Jeff Lorenzen - *American Equity Investment Life Holding Company - EVP & Chief Investment Officer*

And there's obviously many assumptions that go in, everything from surrender -- surrenders, to what we're going to get investment yield plus option costs.

Greg Peters - *Raymond James - Analyst*

Great. Thanks for that color. I can't help myself, but I just had a follow-up on your CLO commentary, in your new investments in CLOs. I was wondering, Jeff, if you could provide us -- I know you've made a lot of comments about it -- providing more color about exactly what you're investing in.

Are you starting in new issues or are you just going into market and by existing? Is in middle-market? Is it syndicated? Large syndicate loans? Just give us some perspective of what you're looking at there. And thank you very much for your answers.

Jeff Lorenzen - *American Equity Investment Life Holding Company - EVP & Chief Investment Officer*

Yes, for the most part it is large syndicated, new issue flow. We haven't gone into the secondary market to pick up flow at this point in time, so it's been a lot of the new flow, new structures coming out. Investment grade, BBB, A type credit quality. Most of them are floating rate. We have gone into an allocation of some BBs.

We tier our managers and their CLOs by a Tier 1, Tier 2 based on track records, their ability to manage through difficult periods of time. We've got a fairly extensive process our team goes through to evaluate managers and determine whether they -- we would consider them a top-tier.

Our top-tier managers would get allocated to the lower credit quality because they've done a better job of managing through crisis than some of our Tier 2s, which might be more of an investment grade quality type manager that we would invest in.

Greg Peters - *Raymond James - Analyst*

Great. Thanks, Jeff.

Operator

(Operator Instructions). Alex Scott, Goldman Sachs.

Alex Scott - *Goldman Sachs - Analyst*

The first question I had was just on the DAC and DSI amortization. I know the absolute number for amortization came in a bit higher quarter over quarter and year-over-year. But I guess relative to the higher EGPs, anyway, like the K factor, looked like it came in a bit lower than it has recently. So I was just wondering if there was anything that you would call out just in terms of market impacts, things like that, that may have influenced it.

Jeff Lorenzen - *American Equity Investment Life Holding Company - EVP & Chief Investment Officer*

So what influenced on DAC and different sales inducement amortization for this quarter was the non -- the effects we had from non-trendable investment income. This quarter we saw our actual gross profits exceed our estimated gross profits that were in the model. That was different than last quarter. That trend was been reversed last quarter.

So, that's the main impact that you see going on, if you are trying to compare to last quarter to this quarter or just looking at DAC and DSI amortization as a percentage of gross profits, was the fact that our actual gross profits were in excess of our estimated gross profits.

Alex Scott - *Goldman Sachs - Analyst*

Okay, that's helpful. And then maybe just on the -- when I think about the realignment and some of the cap rate actions you guys are taking, can you just provide some commentary around the goal of using these two levers? Is it to kind of get spreads back to that high 250s sort of range? Or will the combination of these two items eventually lead to improvement even beyond where we were on 2017 levels?

John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

Well, the real objective on spreads is to get them back to target levels, which are even well above 2017. That would have to take place over time. This action in and of itself may not get that done, but certainly as -- if rates were to continue to rise, that's always been our expectations that we would let our spreads escalate to the pricing target levels. And then at that point in time make an evaluation as to renewal rate increases versus decreases, which has been the trend for the last number of years, given the investment environment.

Alex Scott - *Goldman Sachs - Analyst*

Got it. And then maybe one more quick follow-up, if I could. Could you provide any commentary on surrenders? How you'd anticipate those to play out? Maybe as a percentage of account value or some kind of metric we could think about there. And if there's any impact that you'd expect from some of the cap rate action you're taking?

Jeff Lorenzen - *American Equity Investment Life Holding Company - EVP & Chief Investment Officer*

In regards to any renewal rate adjustment that we would be doing or considering, we wouldn't necessarily be expecting to see surrenders increase significantly because those blocks of policies are still at rates that are quite attractive compared to what current rates are at.

And as we've been commenting for many quarters now, our surrender experience has been quite a bit below what our models had in it for both DAC amortization and different sales inducement amortization. And we've been having to adjust our estimates down in the model in the near-term and then have them grade up as we expect that rates will go up and surrenders will go to a more normalized level.

So this point in time, based upon where current rates are at on current products and the general level maybe of an expectation of what renewal rate reductions we would be making, we're not expecting to see any significant increase in surrenders.

Alex Scott - *Goldman Sachs - Analyst*

Okay, thank you.

Operator

Mark Hughes, SunTrust.

Mark Hughes - *SunTrust Robinson Humphrey - Analyst*

Ron, you gave a number in talking about the pending count of I think 2,048. What was that? Was that at this day last year or was that a different comparison (multiple speakers)?

Ron Grensteiner - *American Equity Investment Life Holding Company - President, American Equity Life Insurance Company*

That was one year ago. Yes, that was one year ago.

Mark Hughes - *SunTrust Robinson Humphrey - Analyst*

And was that both Eagle Life and American Equity?

Ron Grensteiner - *American Equity Investment Life Holding Company - President, American Equity Life Insurance Company*

No, it was just American Equity.

Mark Hughes - *SunTrust Robinson Humphrey - Analyst*

Very good. Thank you.

Operator

John Nadel, UBS.

John Nadel - *UBS - Analyst*

First question is about the pace of sales. Ted, you've spoken in the past that risk-based capital ratio would be relatively stable, all else equal, assuming about $1.5 billion of net production per quarter or $6 billion for the year. At the current level of sales, give or take $4.5 billion annualized, is -- how much should we expect, again all else equal, that RBC can increase on a year-over-year basis?

Ted Johnson - *American Equity Investment Life Holding Company - CFO & Treasurer*

Well, I think -- I mean, I think you probably should really just me looking at the increase we've had for the first six months and annualizing that out.

John Nadel - *UBS - Analyst*

Okay, all right. So that's -- so there's no other real moving parts in that?

Ted Johnson - *American Equity Investment Life Holding Company - CFO & Treasurer*

Yes, plus or minus a couple basis points -- or points, I should say.

John Nadel - *UBS - Analyst*

Okay. And then second question is just on sales mix and the -- there's a lot of commentary about competitive environment. And it seems to me, based on your commentary, and maybe I'm reading too much into this, but it sounds like it's increasingly competitive, relative to first quarter, relative to fourth quarter of last year, etc.

So, sales mix and the nature of the competitive -- or the increasing competitiveness in the market, how should we think about targeted spread on new sales relative to the overall targeted spread on your portfolio?

Ted Johnson - *American Equity Investment Life Holding Company - CFO & Treasurer*

I mean, as the target -- I mean, as we've said, like, even right now we're seeing -- well, I guess on our investment overview we talk about targeted spreads split between premium bonus products and non-premium bonus products. On a bonus product maybe the average spread we're targeting is 300 basis points. On a non-premium bonus product it's somewhere between 165 and 220, something in there, so some midpoint between those.

I think we saw this quarter when we look at spread, and we talked about the cost of money or adjusted cost money going up about 5 bps, about 1 bp of that is really related to just the change in allocation of what we're selling in our in-force. Ultimately how that changes over time with spread is going to be dependent on what the shift in production is and how much we're going to be selling of accumulation versus guaranteed income products.

John Nadel - *UBS - Analyst*

Yes, understood. I guess what I'm getting at is (multiple speakers) -- I'm sorry, go ahead.

Ted Johnson - *American Equity Investment Life Holding Company - CFO & Treasurer*

But again, the ROEs are -- we're pricing the ROEs on both of those products to be relatively the same. And then to remember with the non-premium bonus products, even though we have a lower spread target on those, the offset to that and why our ROEs are relatively the same as the others is because we have last acquisition costs because we don't have a premium (multiple speakers), which means we have less amortization.

John Nadel - *UBS - Analyst*

Yes, that's kind of what I'm getting at. And I know these things can ebb and flow, but it sounds like there's a much larger proportion of your sales, at least currently, is non-premium bonus type of sales. And so optically, if that remained consistent over the next several quarters, optically it seems like your spread may be, quote/unquote, pressured, yet your returns wouldn't be. (multiple speakers) Am I thinking about that the right way?

Ted Johnson - *American Equity Investment Life Holding Company - CFO & Treasurer*

Yes, you are. You're going to see spread contraction, but ROEs are going to stay the same.

John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

This is (multiple speakers) John Matovina. While Ted was answering I realized I had a sheet of paper in my pile here with me that shows a blended spread requirement of about 250 for the premium for the first six months of this year.

John Nadel - *UBS - Analyst*

Got it, that's very helpful.

John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

That's new business, mix of bonus and non-bonus products. Obviously that number will then vary as the premium mix goes, which is what your question went to, but 250 was a proxy for the first six months premium.

John Nadel - *UBS - Analyst*

And (multiple speakers) that's very helpful, thank you.

John Matovina - *American Equity Investment Life Holding Company - Chairman, President & CEO*

And the Eagle Life number -- of course, Eagle Life is a much smaller percentage of overall premium, but Eagle Life is below that. So on the enterprise, the number would even be a little bit smaller than the 250. The 250 was the independent agent American Equity Life distribution.

John Nadel - *UBS - Analyst*

Got you. Thank you so much.

Operator

Thank you. I'm showing no questions at this time. I'd like to turn the call back over to Julie for any closing remarks.

Julie LaFollette - *American Equity Investment Life Holding Company - Director of IR*

Thank you for your interest in American Equity and for participating in today's call. Should you have any follow-up questions, please feel free to contact us.

Operator

Ladies and gentlemen, this does conclude today's conference. Thank you for your participation and have a wonderful day. You may all disconnect.