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Randy Binner *FBR - Analyst*

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PRESENTATION

Operator

Welcome to American Equity Investment Life Holding Company's Third Quarter 2016 Conference Call. At this time, for opening remarks and introduction, I would like to turn the call over to Julie LaFollette, Director of Investor Relations.

Julie LaFollette - *American Equity Investment Life Holding - Director of Investor Relations*

Good morning, and welcome to American Equity Investment Life Holding Company's conference call to discuss third quarter 2016 earnings. Our earnings release and financial supplement can be found on our website at www.american-equity.com. Reconciliations of non-GAAP performance measures discussed on today's call 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 the 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 number of risk 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 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 - Chief Executive Officer*

Thank you, Julie. Good morning and thank you everyone for joining us on the third quarter earnings call. Our third quarter financial results, excluding the effects of the revisions, to our assumptions for deferred policy acquisition costs, deferred sales inducements and the liability for future benefits under lifetime income riders, we're quite similar to the results we've had for the first two quarters of this year and that we experienced continued growth in our earnings base. But we also experienced continued pressure on the rate of earnings on that base or our spread.

Assumption revisions resulted in an operating loss for the quarter of $4.7 million or $0.05 a share. Excluding the impact of the assumption revisions, our operating income would have been just under $48 million or $0.55 per diluted share and those numbers were about $2.2 million and $0.05 a share less than the second quarter 2016 amounts. Roughly half of that sequential decline is going to be attributable to the decline in per share amounts, is going to be attributable to the increased share count from the settlement of our equity forward agreements in early August and the remainder is going to be attributable to increased amortization, slightly higher expenses and a higher effective tax rate.

In addition, the third quarter expenses and income taxes included $1.3 million or $0.02 a share for items that were discrete to the quarter and negatively impacted it. The negative impact from assumption revisions also translated into a lower operating return on average equity. On a trailing 12-month basis, the operating return on average equity was 6.7% based upon our reported numbers and 11.4% if you exclude the impact of the assumption revisions this quarter and what we had in the first quarter of this year.

Going back to the earnings base, during the quarter, our policyholder funds under management rose to $44.5 billion. That was an $820 million or 2% increase from the end of the second quarter. As expected, our gross sales moderated during the quarter from the very strong levels we have seen in the first half of the year, but still remained robust at $1.5 billion. In general, the market for fixed index annuities was competitive in the quarter and our expectation is that the sequential decline in sales that we experienced is going to be consistent with the overall market experience when those numbers get reported by those surveying agencies later this quarter -- later this month.

So, now let me turn the call over to Ted for some additional comments on the third quarter financial results.

Ted Johnson - *American Equity Investment Life Holding - Chief Financial Officer and Treasurer*

Thank you, John. As we reported yesterday afternoon, we had an operating loss of $4.7 million for the third quarter of 2016 compared to operating income of $45.9 million in the third quarter of 2015. The year-over-year comparison is complicated by unlocking of assumptions for deferred policy acquisition cost and deferred sales inducements as well as revisions to assumptions used to determine the liability for future benefits to be paid under lifetime income benefit riders. Excluding the negative impact of the assumption revisions for both this year and last, our operating income for the third quarter was down 12% to $47.9 million or $0.55 per diluted common share compared to $54.7 million or $0.66 per diluted common share for the third quarter of 2015.

Our diluted share count was 6.7% higher in the third quarter of 2016 compared to the third quarter a year ago, primarily due to the public offering of 4.3 million shares of our common stock in the third quarter of 2015 and the settlement of two equity forward sales agreements through the issuance of 5.6 million shares of our common stock in the third quarter of 2016.

We had two discrete items in the third quarter of 2016; an income tax true-up and a write-off of capitalized debt issue costs related to our terminated 2013 line of credit, which negatively affected both net income and operating income by approximately $1.3 million or $0.02 per share. In addition, the spread between the average yield on assets and the cost of money was lower in the third quarter of 2015 and the amortization rate of deferred policy acquisition costs and deferred sales inducements was higher, following our first quarter unlocking of assumptions.

In the third quarter of 2016, we recognized $81.6 million pretax of additional expense due to assumption revisions, of which $61.5 million was related to the liability for future payments under lifetime income benefit riders and $20.1 million was exclusive to deferred policy acquisition costs and deferred sales inducements. The third quarter unlocking of deferred policy acquisition costs and deferred sales inducement assumptions was primarily driven by changes to our spread assumptions. Our projection models assume that current spread levels will normalize over time and we have pushed the normalization back an additional year. Lower level of yield subsequent to the first quarter and following the Brexit vote influenced our decision to push the normalization of the investment spread out an additional year. Our long-term spread assumptions remain unchanged.

We increased the liability for future payments under lifetime income benefit riders by $42 million pre-tax, which resulted in an additional increase in deferred policy acquisition costs and deferred sales inducement and amortization of $19.5 million. The increase in the liability is primarily due to actual index credits on policies being lower than modeled over the last four quarters. The revisions to our assumptions used to determine the liability for the lifetime income benefit rider under GAAP had no effect on our regulatory reserves as actuarial guidelines for regulatory reserves mandate that reserves for fixed indexed annuities with lifetime income benefit riders be computed assuming that policyholders act with 100% efficiency and elect payment streams that maximize the value of their policies on a net present value basis.

Investment spread for the third quarter was 257 basis points compared to 262 basis points in the second quarter as a result of an 8 basis point decrease in average yield on invested assets, partially offset by a 3 basis point decrease in the cost of money. Average yield on invested assets was 446 in the third quarter. The average yield continues to be unfavorably impacted by the investment of new premiums and portfolio cash flows at rates below the portfolio rate. Fee income from bond transactions and prepayment income added 4 basis points to third quarter average yield on invested assets consistent with the second quarter.

The average balance for cash and short-term investments remained high at $1.2 billion compared to $1.1 billion in the second quarter. At quarter-end cash and short-term investments were down to $652 million and have declined to $308 million by the end of October. The average yield on fixed income securities purchased and commercial mortgage loans funded in the third quarter was 331 compared to 395 and 414 in the second and first quarters of 2016. The aggregate cost of money for annuity liabilities was 189 basis points in the third quarter compared to 192 basis points in the second quarter. This decrease reflected continuing reductions in crediting rates and new deposits had a lower cost of money.

The benefit from over hedging the obligation for index-linked interests was 2 basis points compared to a nominal benefit in the second quarter. We have been working to counteract the impact of lower investment yields by reducing the rates on our policyholder liabilities, but the impact on the constant money from these reductions is less than the impact on average yield on invested assets from investment purchases by a few basis points. On September 1, we began implementing renewal rate adjustments on $16 billion to approximately $17 billion of policyholder account values, when fully implemented over the next 12 months to 15 months, we expect these adjustments to lower the cost of money by approximately 8 basis points.

In December, we will begin making renewal rate adjustments on $7.4 billion of additional policyholder account values. These changes to roughly $24 billion of account value are expected to reduce a portion of the 54 basis points cost of money differential between existing rates and the guaranteed minimums we had at the end of the quarter.

On a reported basis, other operating costs and expenses in the third quarter were $25.1 million, which reflects a reduction of $2.8 million in expenses associated with a lawsuit settlement. On an operating basis, which excludes this item, other operating costs and expenses were $28 million compared to $26.8 million in the second quarter and $24.9 million in the third quarter of 2015. The increase in operating expenses this quarter compared to the second quarter of 2016 and the third quarter of 2015 primarily reflected spending related to the Department of Labor's fiduciary rule, the write-off of debt issue costs associated with the termination of the November 2000 credit facility and an increase in reinsurance risk charge expense due to the growth in our policyholder liabilities subject to our reinsurance agreement, pursuant to which we seed off excess regulatory reserves to an unaffiliated reinsurer.

Our estimated risk-based capital ratio is 338%, up from 312% at the end of the quarter and 336% at the end of last year. The increase in the third quarter was attributable to our capital raising activities. As already mentioned, in August, we physically settled the two equity forward sales agreements from our August 2015 public offering and received a $135 million in net cash proceeds. On September 30, we closed on our $100 million three-year term loan. The proceeds contributed to American Equity life on October 3 and have been reflected on -- in our third quarter estimated risk-based capital ratio. The term loan can be repaid prior to its maturity without penalty, providing us with the flexibility to refinance it or pay it off depending upon future production levels.

We also replaced our existing $140 million revolving credit facility with a new $150 million facility that matures in September 2021. Borrowings under this facility are available for general corporate purposes, including capital contributions to our operating subsidiaries and no amounts are currently drawn on this facility.

Now, I will turn the call over to Ron to talk about sales results.

Ron Grensteiner - *American Equity Investment Life Holding - President*

Thank you, Ted. Good morning, everyone. As John mentioned earlier, our third quarter gross sales were $1.5 billion on a consolidated basis, down 16% from the third quarter of 2015 and down 27% from the second quarter of this year. American Equity Life had gross sales of $1.2 billion, down from $1.7 billion in the third quarter of 2015 and $1.6 billion in the second quarter of this year. Eagle Life had gross sales of $348 million, down from $490 million in the second quarter, but well above the $102 million reported a year ago.

Looking specifically at American Equity Life, fixed-indexed annuity premium represented nearly all of the total with multi-year rate guarantee annuity sales dropping as intended to $31 million from $275 million in the second quarter of this year. Fixed-indexed annuity premium of $1.14 billion in the quarter was down from $1.34 billion in the second quarter of this year. That mix of fixed-indexed annuity and multi-year rate guarantee annuity sales by our independent agents is more in line with our historical experience than in the first half of this year.

Discussions with our national marketing organization partners suggest that the sequential decline in our fixed index annuity sales through that channel may reflect an industry-wide fall off in sales. We're not aware of a clear reason why although somewhat decent equity markets this year may have drawn some interest away at the margin from fixed-indexed annuity space, given low caps and participation rates. Our pending application count mirrors this decrease from 3,984 applications pending at the end of June. Pending fell to 3,393 at the end of September and stands at 3,281 as of October 31.

Turning to Eagle Life, third quarter sales were $348 million, fixed-indexed annuity premiums were 44% of the total or $153 million, a decrease from $190 million in the second quarter. Through the first 9 months of 2016, total sales at Eagle Life were approximately $1.3 billion. We believe the decline in sales on a sequential quarterly basis primarily reflects increased competition in the bank and broker-dealer space for both fixed-indexed annuity and multi-year rate guaranteed annuity sales during the quarter.

From 419 applications at the end of June pending at Eagle peaked at 769 in early August and finished in September at 386. As of October 31, pending applications stood at 305. We now have 52 selling agreements in place with Eagle Life, we added one new relationship since our last earnings call and began selling through a potentially significant bank relationship.

I'll finish my remarks with some commentary on the Department of Labor's fiduciary rule as I'm sure you're well aware the rule favors sales of fixed-indexed annuities by broker dealers and banks and poses significant challenges to sales of fixed-indexed annuities by independent agents. The Department of Labor rules specifically identifies four types of businesses that can service financial institutions and sign the best interest contract. Additionally, other types of businesses may apply to the Department of Labor for financial institution status. It has been reported that 18 national marketing organizations have applied to become financial institutions, including several of our major distribution partners.

While we're encouraged by the potential of our national marketing organization partners to become financial institutions, we note that no process for approval currently exists and the timing of any potential approval is unpredictable. Again, we're very gratified by the steps taken by our NMO partners, we will support them and their agents in the fixed-indexed annuity market to the best of our abilities. Meanwhile, we have counted or -- we have continued to take actions of our own to provide alternatives to the fixed-indexed annuities for our independent agents. We have filed traditional fixed rate annuity products and companion lifetime income benefit riders. We plan to introduce these to the market by the beginning of 2017. We believe these products will meet the needs of retirement account holders looking for safety of principal and guaranteed lifetime income and can be sold by agents within the requirements of the less onerous PTE 84.24 exemption.

And with that, I'll turn the call back over to John.

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

Thank you, Ron and Ted. To kind of wrap up and then we'll open to questions. Despite a difficult quarter from an earnings standpoint and the challenges we continue to face from the low interest rate environment and the Department of Labor fiduciary rule, American Equity remains positioned for continued growth and success. Our formula through the years has been to grow our assets, our policyholder funds under management, earning acceptable spread or return on those assets and funds and avoid credit losses in our investment portfolio.

While sales have been slowing, we are still writing business at a very healthy pace that should lead to continued growth in our assets and policyholder funds under management. For the first nine months of this year, our invested assets grew by almost $3.4 billion, which puts us on a pace for an 11.5% growth rate for this year. And of course, while sales of fixed-indexed annuities could slow next year if the Department of Labor rule is not delayed or otherwise overturned through litigation, we would expect growth to reassert itself over time as the need for principal protected retirement savings and income products will only increase as Americans continue to age.

The headwinds from the low interest rate environment remain perhaps our biggest challenge. Clearly higher rates would ease the challenge, but in the absence of higher rates, we have planned to continue to manage renewal rates within the framework of [prudent] treatment of our policyholders that preserves our long-term franchise value. And even with the adjustments Ted commented upon earlier, we still have room to lower rates and index terms before hitting guaranteed minimums on a large portion of our existing business. And as we always say, the credit quality of our investment portfolio remains high and we continue to invest, while maintaining our discipline of avoiding excessive credit risk. As we've stated many times in the past, one of our key promises to our agents and policyholders is that policyholders can trust us to be there when they need their money, whether that be tomorrow or decades from now.

So thank you for your time and attention this morning. And operator, we'll let you handle the questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) John Nadel, Credit Suisse.

John Nadel - *Credit Suisse - Analyst*

That'll happen from time to time. I guess my first question is, I know in the past you've indicated a likely unwillingness maybe even more than likely a unwillingness, an unwillingness to play the role of the financial institution when it comes to the use of the big exemption for indexed annuity sales through independent agents. I guess as you evaluate whether the national marketing organizations will or won't get approval to take on that role and maybe they do, but ultimately it takes longer than the implementing -- or beyond the implementation date, have you given any further evaluation to that might change your opinion on taking on that role of financial institution?

Ron Grensteiner - *American Equity Investment Life Holding - President*

This is Ron. As we look at that, as I mentioned in my comments, it's certainly uncertain whether any of those marketing companies will get financial institution status. We're kind of operating -- looking that our marketing companies are doing a good drop to trying to find a path to help those independent agents either by owning a registered investment advisor or maybe the owner, broker-dealer and those are two of the financial institutions that to deal [well I said can] sign the BIC. So, because of those, marketing companies are doing a good job with that. We feel that they are in a position that they will be able to sign the BIC for the independent agents.

John Nadel - *Credit Suisse - Analyst*

And of your 10, let's say as an example, most prominent or most important national marketing organization relationships, how many of those are you aware of have filed to try to get approval?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

The majority have filed for approval or they own a broker-dealer or RIA, so the majority.

John Nadel - *Credit Suisse - Analyst*

And then I have a question with respect to the co-insurance arrangement for Eagle with -- I believe it's Athene, is there any room within the contractual terms of that agreement for you guys to adjust the percentage that you co-insure away to the extent that you saw real pressure through the independent agent channel, but wanted to retain a higher percentage of the production through the financial institution channel?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

This is John Matovina. John, the terms of the agreement with Athene do specify a declining ceding percentage to them over time. I think that two years after this would be at 80%, and then in three years from now it drops to 20%. So, that's the contractual relationship we have in the existing agreements.

John Nadel - *Credit Suisse - Analyst*

I guess my question is particularly the early part of it at 80%, it seems to me that's the exact portion of the calendar let's say where you might like to see that flip the other way?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

The 80% expires this year and it flips -- reduces to 50% next year.

John Nadel - *Credit Suisse - Analyst*

Okay. Understood. I'm just wondering if there's any chance to reduce that further if you could renegotiate?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

We obviously could have conversations with them, if then -- but not predicting what those might be or what the resolution that might be.

John Nadel - *Credit Suisse - Analyst*

Okay. Understood. And then lastly, just as you -- new money was I think 3.31% in the quarter, any significant change in that to-date in the fourth quarter? I'm guessing probably not much.

Ted Johnson - *American Equity Investment Life Holding - Chief Financial Officer and Treasurer*

In October, we saw purchases coming in -- investments coming in around 3.35%. So, not significant for what we've seen in October.

Operator

Greg Peters, Raymond James.

Greg Peters - *Raymond James - Analyst*

I just wanted to circle back to your comments on sales. We're listening to the results of one of your competitors and they talked about lower commission rates on FIA products and an expectation of lower sales. And Ron, I was trying to reconcile sort of your indications on pending applications versus the upper -- the sales on a year-over-year and a sequential basis. Can you give us some color on how I should be thinking about this going forward going into the implementation of DOL next year?

Ron Grensteiner - *American Equity Investment Life Holding - President*

First of all, when we look at the sales, I think the whole industry is off a bit. And as I mentioned in my comments, I think part of it is due to the equity markets are pretty decent and I think some of the money may be there. We hear also some chatter about the election. People are kind of standing on the sidelines, waiting to see who our next President will be. But as we look for the DOL and what's going to happen next year, that's really the million dollar question. I think there is going to be an adjustment period as people get used to the new DOL rules, particularly when the BIC is involved for qualified money and FIAs.

So, that's a tough one to ask, but I guess our answer -- but I would expect probably some softening in sales next year. But we like to be optimists too, because as we've also said retirees and pre-retirees won our products and our pool of prospects continues to increase every year. So, hopefully after a brief pause, we can see attraction to our products increase again once people get used to the new rules.

Greg Peters - *Raymond James - Analyst*

So, just a follow-up to that point, you would expect it to normalize at a new base later next year and then start growing from there. Is that sort of a right way to think about it?

Ron Grensteiner - *American Equity Investment Life Holding - President*

I'd probably say that. I don't know a better way to answer that question I guess, but I think you could maybe say there will be a reset button. There will be broker dealers. This may be the smaller ones that the BIC is going to say, "Well, we don't want to mess with the new Department of Labor rules" There may be some more senior agents that don't want to go through the hassle and so the distribution channel may contract a bit and so that maybe a reset point.

Greg Peters - *Raymond James - Analyst*

My second question is just on strategic alternatives, considering your current stock price. I know you're mindful of RBC ratios, but with the stock where it is. Is there any way you could consider some sort of capital management initiative to supplement what's going on internally?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

We'd like to, Greg. This is John Matovina. I mean the capital there at the 338% given the uncertainty of what's going to happen in the marketplace and we certainly don't want to have a situation occur, where the DOL rule gets delayed, stalled by litigation for whatever reason and have high levels of sales and not have the capital to support it. So, I view us as being somewhat on hold from that until we determine whether we have that reset button and where the longer-term capital needs. And it is frustrating to not have more flexibility at the moment, but that's the position we're in.

Operator

Pablo Singzon from JPMorgan.

Pablo Singzon - *JPMorgan - Analyst*

My question was about the riders (inaudible)(29:50) the third quarter was obviously a negative result. But how has a living benefit rider tracked your expectations over time? (inaudible) have negative unlockings been offset by positive unlockings before? Also what is your comfort in terms of preserving assumptions?

Ron Grensteiner - *American Equity Investment Life Holding - President*

Couple different things there. One will mean we're comfortable with our reserving assumptions that we have in the lifetime income benefit rider and obviously one of the main assumptions in that model is how many people are ultimately going to elect to turn it on and we feel that we have fairly conservative assumptions that we've made in that and they might be overly conservative, but that will yet to be seen as the rider plays out over a long period of time. Since we don't have the historical -- a great deal of historical experience to go by, we've made sure that those election percentages have been very conservative.

So we feel good about our assumption. Now, there can be volatility, some as what we've seen in this quarter based upon what actual indexed credits are versus what's modeled in the models and then due to the way the process that we handle in regard we're doing reserve revisions to assumptions we have this true-up of bringing in the current account values, which you've seen the volatility that's there. So, I think there's been points in time in the past, where we've had positive results related to account values being greater than what is estimated, but those could have been offset by other revisions to assumptions that netted it down to a lower amount than what we've seen in this quarter. Now, did that answer your question?

Pablo Singzon - *JPMorgan - Analyst*

It does. Thank you. And then I just like to switch gears a bit. So, in response to the DOL, some broker dealers have spoken about trimming their (inaudible)(32:00). How do you think that will affect DOL's efforts (inaudible) life?

Ron Grensteiner - *American Equity Investment Life Holding - President*

So, it's on shelf space. How do we think --

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

We are in a hard time understanding.

Ted Johnson - *American Equity Investment Life Holding - Chief Financial Officer and Treasurer*

I don't know that we haven't had any -- we haven't seen any indications for broker dealers that we're dealing with or who we're talking to you to get on the shelf that they're starting to limit shelf space or limit their conversations about bringing on additional carriers into the marketplace and maybe I'll let Ron expand on that.

Ron Grensteiner - *American Equity Investment Life Holding - President*

I would agree with that. But it is one thing that we're not going to take for granted. We do want to stay front in the center in those broker dealers and financial institutions to make sure that we need to stay on the shelf by being visible and present and keeping our products competitive.

Operator

Randy Binner, FBR.

Randy Binner - *FBR - Analyst*

I have a couple on sales. I guess the first is and this is in regard to ways that you can pivot the franchise in order to sell post DOL fiduciary rule next April. The first is that you did file the traditional fixed rate annuity product you mentioned that and there some companion riders on lifetime income benefits. Can you -- two questions there. One, is there any sort of initial market reception that you can share on how your IMO and independent insurance agents are reacting to that, because I assume that this will be a product that would be geared towards them assuming that IMOs cannot be financial institutions? And then secondly, can you just give us a little more flavor of kind of what these products look like?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

Sure. I guess as far as the products that we filed, they are traditional, what I'd call, declared rate annuities. We filed some, I guess I call them, chassis that we have the flexibility to roll out or introduce different versions. So, for example the chassis maybe a five-year surrender term and then we could also change it to an eight-year surrender term or an eight year surrender term or 10 year surrender term, typically the longer the term the higher the interest rate would be and potentially higher the compensation would be as well. So, we would reset the declared rate from year-to-year depending on the yields available to us. I would compare it to our current Choice series, but just unhooking all of the index-linked strategies. So if you would look at our Choice 10 for example, it has a fixed strategy that's paying about 2% interest. And so, that's what I would say our new declared rate portfolio would look like, then we'll have some bonus -- premium bonus -- premium or interest rate bonus versions and some non-interest or premium rate structures.

When we talked to our field earlier this year, we did kind of an informal survey of reaching out to several of our producers and asked them what they thought about that if they would be open to selling at declared rate annuity versus an FIA. And the answer was, yes, of course, they would particularly though if it had a competitive lifetime income benefit rider attached to it, because they tell us, for a good chunk of their sales income is more of the driving force then accumulation is.

So I guess it's a combination between principal protection and income. So that's what we think it's going to look like and finally, I guess I just want to get out there that we think that our marketing companies are working very hard to be able to find a pathway to sign that best interest contract and we're always going to be supportive of FIA sales in the independent channel whether it be non-qualified business or whether it be qualified business where the BIC is involved.

Randy Binner - *FBR - Analyst*

And then on, I guess on the broker-dealer and bank front, with Eagle Life, I covered a little bit I think in piece of the commentary here, but I guess I just like to come back and understand the slowdown in sales that was kind of expected, because it had popped in previous -- last few quarters, but then there are also some of this kind of lower aggregate demand for index annuities market wide in that, bank and the D channel or was that more on the traditional channel?

Ron Grensteiner - *American Equity Investment Life Holding - President*

I think it was experienced in the bank and broker-dealer channel too particularly, all those registered -- and there was registered reps who are selling mutual funds and ETFs and those types of things because we're seeing some decent equity markets. They're probably losing some focus on principal protection and guaranteed products. So that's certainly part of it. When you look at the caps and par rates that we have, they're leaning that direction. I think they two though are looking at the DOL and considering what they have to do next year, I think the DOL also plays a part, but I just think decent equity markets have a good reason for it.

Randy Binner - *FBR - Analyst*

My follow-up is going be like, do you think there's a chilling effect from the DOL rule change? I mean they all -- the folks who sell the products are smart and they get all the newsletters and so they know that index annuities were switched in. Do you think there is a chilling effect to that on what they would do with the product now? What I'm thinking of is in my mind, there should be a sales spike of indexed annuities ahead of the rule I would think, but to see a slowdown now is a little unexpected. So just trying to figure out if you think there's kind of some chilling effect from what the DOL is doing now?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

I guess I don't know. It's a good question, Randy. I think the institutions themselves are certainly evaluating what they need to do but from a registered rep standpoint, I don't think they are in the mix yet, deciding whether or not FIAs are going to be a part of their future offerings. I think FIAs. When you consider FIA stay under the BIC along with variable annuities, we're kind of optimistic that FIAs will be easier to sell particularly for guaranteed income in the future than VAs because of the structure of VAs with their higher embedded costs spend fixed-indexed annuities.

Operator

Mark Hughes from SunTrust.

Mark Hughes - *SunTrust - Analyst*

Ted, is there kind of a formulaic way to look at what we might expect in terms of a DAC unlocking in the future if interest rates -- if we do the lower for longer interest rates don't start to normalize, do we just assume we have another quarter like this, sometime next year? Does it happen, once a year, twice a year? Is there any way to just sort of roughly shape up if it's lower for longer, what does that mean in terms of the trajectory of future unlocking?

Ted Johnson - *American Equity Investment Life Holding - Chief Financial Officer and Treasurer*

Now this year was unusual, because we had two unlockings in one year and obviously it's been an unusual year in regards to what has happened with interest rates. So I wouldn't -- I don't know that I can say I can't expect that to happen again, that's determined on what happens in the markets, but I mean that's why we had two of them this year. Otherwise, historically it's always been just one. In regards to -- I don't necessarily know that can predict. I can't really predict for you in the future on what will happen. I can tell you what we have currently done in the model is assumed that spread is going to remain level for a couple of years and then grade up over a five-year period of time.

Mark Hughes - *SunTrust - Analyst*

And if you -- and again just sort of roughly if we find ourselves next year and no change in outlook sentiment, the curve looks similar and your judgment at that point is it's going to be the same thing and you're going to take the same approach, spread like you've got it now for a couple of years and then it normalizes, what is it, is that another $0.60 hit, is that a way to think about it?

Ted Johnson - *American Equity Investment Life Holding - Chief Financial Officer and Treasurer*

I don't have any answer for that, Mark.

Mark Hughes - *SunTrust - Analyst*

You sort of roughly does that --.

Ted Johnson - *American Equity Investment Life Holding - Chief Financial Officer and Treasurer*

I'm sorry. There's more people talking here. Say your question again.

Mark Hughes - *SunTrust - Analyst*

I was really just asking the same question again. Roughly, is that ballpark-ish or is it just so inherently unpredictable?

Ted Johnson - *American Equity Investment Life Holding - Chief Financial Officer and Treasurer*

It's inherently unpredictable. I don't think you can assume that same level of DAC unlocking would resolve next year at the same time.

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

He said $0.60 hit, and the $0.60 number was DAC plus [the liver liability]. The DAC on its own was only 25% of that. So, it would be very surprising that stretching out delaying the normalization of spread for another year or two would be a $0.60 hit.

Ted Johnson - *American Equity Investment Life Holding - Chief Financial Officer and Treasurer*

Because only $20 million of the adjustments was related to DAC related to changes in assumptions and the majority of that $20 million was related to investment spread.

Mark Hughes - *SunTrust - Analyst*

And so if interest rates are lower for longer, the potential impact if we just take a look back at what's happened over the last year. It's something less than your quarterly operating earnings run rate. Is that fair? I guess we can make our own assumptions. You've helped to frame up the answer. Thank you.

In the independent channel, I don't know if you addressed this directly. There's been a lot of talk about it, but do you think within the independent channel, there's been turmoil as well? They've been distracted and just not selling with the same intensity because of all this chatter or have they been trying even harder knowing that the things could be tougher in the future?

Ted Johnson - *American Equity Investment Life Holding - Chief Financial Officer and Treasurer*

Well, good question. I think from -- if you're talking about the producer out on -- that's out making the sales, I think that they probably hear about it and think about it, but I don't think that as dissuading them from selling. Certainly the marketing companies and the NMOs, they're highly engaged right now on getting their processes and their procedures, and doing whatever they have to do in a post DOL world to try and comply and sign the BIC. So the people that are actually doing the sale, I think that they're just doing what they do. And with the low rate environment that we have when you look at caps, or FIAs in the 2.25 range, it's I guess better than a CD, but it certainly the lowest caps we've ever experienced and it's a little bit tougher market out there.

Operator

John Barnidge from Sandler O'Neill.

John Barnidge - *Sandler O'Neill - Analyst*

The thank you. Just a couple questions. When was investment spread on a reported basis just low?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

Excuse me, did you say when?

John Barnidge - *Sandler O'Neill - Analyst*

Yes. When was the last time it was below 2.57?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

Precedes my time. This is John.

John Barnidge - *Sandler O'Neill - Analyst*

Couple of others. You may not be able to --.

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

Which is my time is 13 years.

John Barnidge - *Sandler O'Neill - Analyst*

I see. Can you talk about a potentially significant BD relationship you cited in the press release? I know maybe too early, but just wondering on that.

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

I think we said we had a new bank relationship in the press release.

John Barnidge - *Sandler O'Neill - Analyst*

You said you began selling through a potentially a significant bank relationship. Sorry, I said broker dealer. Could you extrapolate on that at all, or no?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

Well, we don't usually make it a practice to -- on this particular call anyway to say who the accounts are that we've signed up, or that are going to start sending this business. So we'll decline on that.

John Barnidge - *Sandler O'Neill - Analyst*

Okay. Do you have any thoughts on the DOL FAQs that were released last week? And then any updates on litigation efforts?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

Well. Certainly no update on litigation. Everybody knows couple of cases have had hearings, but no decisions from the court yet or the judge on those cases. And the three suits in Texas I think go to the judge two weeks from today. And so, that's the litigation. In terms of the FAQs, we are still consulting with lawyers and other advisers and monitoring our fellow industry participants to assess whether those frequently asked questions are going to provide enough comfort for an insurance company to sign the best interest contract, but we haven't reached a conclusion yet.

Operator

Tom Gallagher, Evercore ISI.

Alex Scott - *Evercore ISI - Analyst*

Hi, you've actually got Alex Scott. I have a quick follow-up on the DAC assumptions. Can you provide just the -- I guess ultimate spread assumption that you're using in the model?

Ted Johnson - *American Equity Investment Life Holding - Chief Financial Officer and Treasurer*

Well, within the model, there is really not just one ultimate spread, because there's differing spread targets related to differing products. And so there's not just one number, I would say. Prior to 2014, within the model of the products we were sold were basically close to all of the same spread target. So the ultimate spread for the block of business that's in there prior to 2014 is 285, and then the future blocks are at a lower amount.

Alex Scott - *Evercore ISI - Analyst*

Got it. And then you mentioned that there wouldn't be a need necessarily for DAC unlock if spreads remain level for the next, I think it was a couple of years, few years, but I know in your remarks --.

Ted Johnson - *American Equity Investment Life Holding - Chief Financial Officer and Treasurer*

I caution on that, you could always have that's what our assumption is today, but we could get to next year, and based upon what the rate environment maybe we decide then that the rate environment is going to be lower for longer than that. And so, you might have to push it out just like we pushed it out this year.

Alex Scott - *Evercore ISI - Analyst*

Okay. And I just want to check on the comments regarding the -- I guess spread compression in the investment side relative to the cost of credit, and I think you said the spread compression was a few basis points greater kind of expected for the next, I think it was like the next 12 to 15 months you were referencing. Is that kind of accounted for in the DAC model already or as we see that spread compression over the next 12 to 15 months without pressure on, meaning the DAC unlock for just like that piece of it alone?

Ted Johnson - *American Equity Investment Life Holding - Chief Financial Officer and Treasurer*

When we do the DAC model, we're looking at, one, where we think the overall yield on the portfolio is going to go based upon assumptions of what we think is going to be available to us to be able to invest in over time, which takes into consideration the roll off of -- how much would roll off of the portfolio and have to be reinvested. So we're taking that into consideration along with taking into consideration the rate decreases that we have started to implement on the end-force block of business and how that would roll through and reduce the cost of money. So we're looking at both of those. So the answer is yes, we're taking into consideration future spread compression. They could happen, what couldn't be offset by the rate changes that we put in place to day.

Operator

Kenneth Lee from RBC Capital Markets.

Kenneth Lee - *RBC Capital Markets - Analyst*

Just want to dig a little bit more into the competitive activity within the Eagle Life distribution channel. Just wondering, we've obviously heard a bunch of other insurers talk about fixed indexed annuities. Wondering whether you're seeing like new entrants within that channel or more competitive terms, or just want to get more detail in terms of the activity?

Ron Grensteiner - *American Equity Investment Life Holding - President*

Hey Ken, it's Ron Grensteiner. As far as new entrants, I don't -- is there one --?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

I forgot the name of the company, but there's been one that's been picking up for the last several months, yes.

Kenneth Lee - *RBC Capital Markets - Analyst*

For new insurance companies?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

Yes.

Ron Grensteiner - *American Equity Investment Life Holding - President*

I don't know who that is. There's been another company in this that's relatively new to the space that we used to have kind of the exclusive on the participation rate strategy.

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

And we were the only carrier that had a participation rate strategy and that was one of the things that was attractive about our product mix, and now we have some competition in there. And they've had their participation rates a little bit higher than we've been willing to put ours at and I presume that's to get their foundation or foot in the door.

Ron Grensteiner - *American Equity Investment Life Holding - President*

Yes, for the life of me, I can't member who that is, but John is right. There is probably another company that joined. And there are some of our competitors too that have added that strategy that John referred to a participation rate strategy where we were a little bit unique to try and steal back some of that market share. So, it is a market where it's a little bit more rate sensitive than in the independent agent channel. So, we have to pay really close attention to where our capitals and participation rates are for sure in the bank and broker dealer channel.

Kenneth Lee - *RBC Capital Markets - Analyst*

And then broadly speaking, in terms of the independent channel. Just a follow-up in terms of the sales decline that you've seen this year in the most recent quarter. Has there been any changes -- because you mentioned low cap rates, but has there been any changes in terms of the cap rates in the third quarter versus the second quarter, or changes in the sales commission that that could explain that?

Ron Grensteiner - *American Equity Investment Life Holding - President*

Well, there has been a little bit of that. It was in the -- probably earlier in the third quarter where companies are making adjustments to the terms of their guaranteed income benefit. Some have reduced compensation and some have reduced their caps and participation rates. With that happening, what generally -- the result is generally there is a sense of urgency that's created in the independent agent channel to get those sales in before the new terms take effect, but we really didn't see that this time around or didn't notice it anyway as evidence that we think that third quarter sales are going to be down compared to second quarter sales and that's when most of those adjustments took places in the third quarter. So, it's an interesting phenomenon.

Kenneth Lee - *RBC Capital Markets - Analyst*

And one final question in terms of the lifetime income benefit rider, if you were to look at it from the statutory perspective, it sounds like you're going to see full utilization than mortality would probably be like the only major risk exposure for you guys. Is that still true?

Ron Grensteiner - *American Equity Investment Life Holding - President*

Well, I guess, I mean -- yes, if the people you're using -- a mortality table has to be built into there as part of the calculation. But so then if people would be living longer than that would be, but I don't know that that's not the biggest --.

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

I don't think -- I was trying to make sure I had -- I was hearing your question right, because certainly a deviation in mortality could be a big risk, but the efficiencies that are built into the statutory calculation -- or actually their -- I guess the way to say this, yes, you probably got it right, because assumed mortality influences all the other decisions that create the maximum present values.

Ron Grensteiner - *American Equity Investment Life Holding - President*

Because it will assume -- it assumes when somebody's going to die and then it makes a decision, okay, the optimum time for that person to start receiving income is X. And so if the assumption on their mortality is incorrect, then everything else is going to change and it's all going to flow from the actual mortality.

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

From a reserving calculation, mortality tables get locked in. So the mortality tables that you use are locked in when the policy is issued. So the only way that the reserve goes up under a regulatory reserve calculation is if we have to adopt a new mortality table, but those new mortality tables only apply to new issuances.

So if they guess it, really at the end of the day it doesn't really affect the regulatory calculation. On an economic basis, yes, if people live longer than what we have estimated, then that can have an effect on an economic basis, but not so much on a statutory regulatory reserve.

Ron Grensteiner - *American Equity Investment Life Holding - President*

And the other thing that would happen on a statutory reserve though is as people actually elect, then the calculation gets converted to a more definitive because -- but that point time mortality, it is a payout type annuity and mortality is the only consideration. I know we wouldn't mind seeing more people say start electing now, because that would remove an element of the reserve that is -- reflects continued deferral or accumulation before income being activated.

Operator

Erik Bass from Autonomous Research.

Erik Bass - *Autonomous Research - Analyst*

Thank you. Just want to follow-up actually on the lifetime income benefit rider. And it does seem like the assumptions are pretty conservative from a statutory standpoint. Just can you talk about how those compare to your GAAP assumptions and maybe what the kind of the gap and reserve is between the two?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

So, on a GAAP basis, the biggest difference would be utilization. So on a GAAP basis, we assume if it's a fee rider 75% are going to turn it on and utilize. And if it's a no fee rider, the assumption is half of that. Over on statutory, you're assuming a 100% utilization and that they're turning it on at the most efficient point for the policyholder. So that's going to be the big difference between the two. We feel that however on our best estimate assumptions over on the GAAP side that we have been conservative in regards to when or how many people are going to turn it on. But as I said before, we don't have historical experience or enough of a historical experience to really base any different assumptions than what we currently have for utilization.

Erik Bass - *Autonomous Research - Analyst*

Got it. That's helpful and is their way to convert that to a dollar amount? If you were to set your GAAP utilization assumption equivalent to your statutory to 100% utilization?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

Well, certainly we could adjust our approach and say run reserves run GAAP reliability calculation at 100% utilization to produce a number.

Erik Bass - *Autonomous Research - Analyst*

Yes. That's -- I was wondering if you had just --.

Ted Johnson - *American Equity Investment Life Holding - Chief Financial Officer and Treasurer*

We don't have that.

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

We have not done that.

Operator

John Nadel from Credit Suisse.

John Nadel - *Credit Suisse - Analyst*

I had two real quick follow-ups. Is there any significant difference between the capital requirements to issue a traditional fixed annuity with a lifetime income rider versus what is your more common and historical product the indexed annuity with a lifetime rider?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

No.

John Nadel - *Credit Suisse - Analyst*

Okay. And then the risk-based capital ratio inclusive of the capital injection is 338, how much cash and resources do you still have at the holding company beyond that as of the end of the quarter?

Ted Johnson - *American Equity Investment Life Holding - Chief Financial Officer and Treasurer*

I'll have to get that answer for you, I don't know how much cash is still sitting at the holding company that would be available.

Obviously the other resource is -- the fall back is the line of credit, which is $150 million, where nothing has been drawn upon that.

John Nadel - *Credit Suisse - Analyst*

Yes. Understood. Just trying to get a sense for -- I'm sure the holding company has some ongoing cash needs even if it's --.

Ted Johnson - *American Equity Investment Life Holding - Chief Financial Officer and Treasurer*

Right. There's not --.

John Nadel - *Credit Suisse - Analyst*

Common dividend and interest expense.

Ted Johnson - *American Equity Investment Life Holding - Chief Financial Officer and Treasurer*

Yes. There's not going to be an overly significant amount of money sitting at the holding company to be [able to down right] now, that could build up over time, but --.

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

And the holding company funds its cash needs primarily. We have in investment management agreement between a subsidiary of the holding company, which houses all of our investment professionals and staff, and each of the insurance companies in that agreement in the rate of compensation has been approved by the Iowa Insurance Department. And so the fees that come out of that exceed the expenses of the operation, and provide a big chunk of -- or perhaps all of the cash flow that the holding company needs to service the debt obligations that it has and obviously pay its expenses and paid cash dividend. And then the holding company also -- $51 million of the holding company's capital investment in the insurance company is in a surplus note that provides for annual payments of interest.

John Nadel - *Credit Suisse - Analyst*

And then just lastly, just when you attach a lifetime income rider to a base fixed annuity -- fixed-indexed annuity contract, how much does the capital requirement per, I guess, dollar of deposit, how much does that increase? If a traditional fixed-indexed annuity is what -- about 5% or 6% equity to deposits? I think that's about right. How much does it change when you add the lifetime income rider?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

I don't have a number for you on that scale, but just all it's really going to do is, in a policy without a rider, you got it in general terms the cash surrender value is the reserve and that's where you calculate your required capital under what they call C3. And a policy with a rider is going to have a reserve that's a little bit higher than the cash surrender value for the -- huge value of the future benefit. So, it's not necessarily going to be a big number at the start, but over time, as a policyholder allows his rider benefit to accumulate, the amount of capital will have to go up, because you still got a little higher reserve.

Ron Grensteiner - *American Equity Investment Life Holding - President*

Now, also remember, because of the way that statutory reserving rules work and you [have to -- select a benefit], you have to assume 100% utilization. We do have a reinsurance agreement in place with Hannover, where we seed off excess reserves to them. And so we fund part of that because of those very conservative reserving regulations that we have to follow. We do seed off a piece of that reserve to Hannover at a low cost for us.

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

I look forward to following up on the stuff, because it seems there could be even if it's not a permanent, that could be a pretty -- it could be a pretty meaningful shift in the type of annuity production at least over the -- let's say, the next 12 or 18 months.

John Nadel - *Credit Suisse - Analyst*

Post the DOL?

John Matovina - *American Equity Investment Life Holding - Chief Executive Officer*

Yes, as we approach it and certainly post it.

Operator

Thank you. And I'm showing no further questions from our phone lines. I would now like to turn the conference back over to Julie LaFollette for any closing remarks.

Julie LaFollette - *American Equity Investment Life Holding - Director of Investor Relations*

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, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Everyone have a wonderful day.
