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PRESENTATION

Operator

Welcome to American Equity Investment Life Holding Company's Third Quarter 2017 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 L. 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 third quarter 2017 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; Ron Grensteiner, President of American Equity Life Insurance Company.

And 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 the 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 Michael Matovina - *American Equity Investment Life Holding Company - Chairman, CEO & President*

Thank you, Julie. Good morning, everyone, and thank you for joining us this morning. Our core third quarter financial results remained strong, and they continued the solid trends we saw in the first half of the year.

Non-GAAP operating income for the quarter was $87.2 million or $0.96 per share. And excluding the impact of the actuarial assumption reviews and the loss on extinguishment of debt, our operating income would have been $63.6 million or $0.70 per share.

So as a reminder, the 3 key areas that drive our financial performance are: growing invested assets and policyholder funds under management, generating a high level of operating earnings on the growing asset base through investment spread and then minimizing impairment losses in our investment portfolio.

For the third quarter of 2017, we delivered 1.5% sequential growth in policyholder funds under management. That translates into a 7.1% increase on a trailing 12 months basis. On a trailing 12 months basis, we generated a 12.3% non-GAAP operating return on average equity. That excludes the impact of the actuarial assumption reviews and the losses on extinguishment of debt. And our investment impairment losses after the effects of deferred acquisition costs and income taxes was -- were less than 0.01% of average equity.

The growth in policyholder funds under management for the quarter was driven by $915 million in gross sales. Our product offerings have not been as competitive as they had been in prior periods. However, since late June, we've captured higher new money yields on investments, which allowed us to enhance our product offerings in competitive positioning in September and October. You'll hear more about those from Ron a bit later.

We had a modest sequential decrease in our investment spread in the third quarter, primarily reflecting a lower benefit from bond transactions and prepayment income. The investment spread also benefited from the higher new money yields on investments. And our low level of 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 third quarter financial results.

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

Thank you, John. As we reported yesterday afternoon, we had non-GAAP operating income of $87.2 million or $0.96 per share for the third quarter of 2017 compared to a non-GAAP operating loss of $4.7 million or $0.05 per share for the third quarter of 2016.

We had one discrete item in the third quarter of 2017 an $18.4 million pretax loss on extinguishment of our 6.625% Notes due in 2021, consisting of $13.3 million of redemption premium and the write-off of $5.1 billion of debt issuance cost. The loss on extinguishment of debt reduced both net income and operating income by $10.8 million or $0.12 per share.

Third quarter 2017 operating income included a net benefit of $34.4 million or $0.38 per share from revisions to actuarial assumptions. On a pretax basis, the revisions reduced amortization of deferred policy acquisition cost and deferred sales inducements by $75 million and increase the liability for future payments under lifetime income benefit riders by $21.6 million for a net pretax increase in operating income of $53.4 million.

Revisions to actuarial assumptions in the third quarter of 2016 increased amortization of deferred policy acquisition cost and deferred sales inducements and the liability for future payments under lifetime income benefit riders by $81.6 million and reduced operating income by $52.6 million or $0.60 per share.

The third quarter unlocking of deferred policy acquisition cost and deferred sales inducement assumptions was primarily driven by higher-than-modeled account values, which translates to increased projections of expected gross profits in future periods. The increase in the liability for future payments under lifetime income benefit riders was driven by changes to our account value growth projections. Although interest credits were well above expectations, the benefit from this was more than offset both by decreases in our assumptions for expected lapses as well as changes in our assumptions for future account value growth.

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 a 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 270 basis points, down 2 basis points from the second quarter of 2017 as a result of a 2 basis point decrease in the average yield on invested assets. Average yield on invested assets was 4.43% in the third quarter compared to 4.45% in the second quarter. The decrease in the average yield in the quarter reflected a lower benefit from nontrendable investment income items, which added 5 basis points to the third quarter average yield on invested assets compared to 8 basis points from such items in the second quarter of 2017.

Nontrendable investment income in the third quarter of 2017 consisted entirely of fees from bond transactions and prepayment income. The contribution from an acceleration of the rate of pay downs on residential mortgage-backed securities was di minimis in the quarter. The average yield on fixed income securities purchased and commercial mortgage loans funded in the third quarter was 4.39% compared to 3.96% in the second quarter of 2017 and 4.13% in the first quarter of 2017. The higher rate in third quarter reflects an increase in the amount of NAIC 2-rated structured assets purchased. In October, we invested new money at 4.40%.

The aggregate cost of money for annuity liabilities was 173 basis points, flat with the second quarter. The benefit from overhedging the obligations for index-linked interest was 6 basis points in both the third and second quarters of 2017. We continue to have flexibility to reduce our crediting rates, if necessary, and could decrease our cost of money by approximately 47 basis points if we reduce current rates to guaranteed minimums. This is up from 46 basis points at the end of the second quarter.

Interest expense on notes payable for the quarter was $7.6 million. That's down from $8.7 million in the second quarter. Interest expense decreased due to the refinancing of our 6.625% Notes due in 2021, with 5% Notes due in 2027. The 6.625% Notes were redeemed on July 17, and we recognized $1.2 million of interest expense for the 16 days that 6.625% Notes were outstanding during the third quarter.

Other operating costs and expenses in the third quarter were $28.7 million, which was a $2.8 million increase on a sequential basis. Half of this amount was related to the reduction in the liability for payments expected to be made pursuant to the retirement agreement with our former Executive Chairman that we recognized in the second quarter. The remainder of the increase primarily reflects higher salaries and increases in incentive compensation accruals.

Our estimated risk-based capital ratio at September 30 is 375%, up from 366% at the end of this year's second quarter. The increase in the RBC ratio included 4 points from a decline in required capital for production, and we estimate -- which we estimate using a 12-month sales. The increase in our adjusted statutory capital and surplus exceeded the increase in required capital from growth in assets and reserves and accounted for the remainder of the third quarter increase in our RBC ratio.

Now I'll turn the call over to Ron to discuss sales, marketing and competition.

Ronald J. Grensteiner - *American Equity Investment Life Holding Company - President of American Equity Investment Life Insurance Company*

Thank you, Ted. Good morning, everyone. As we reported yesterday, gross sales for the third quarter of 2017 were $915 million. This is down from sales of $1.5 billion in the third quarter of 2016 and $1.2 billion in this year's second quarter.

Third quarter 2016 sales included $226 million of noncore multiyear guaranteed annuity sales, of which 80% was co-insured. Third quarter 2017 had just $16 million of sales from multiyear products.

Net sales for the quarter were $834 million compared to $1.1 billion a year earlier and $1.1 billion in the second quarter of this year. As a reminder, beginning this year, we are retaining 50% of all Eagle Life fixed indexed annuity sales, up from 20% previously.

Recent reports from several of our competitors suggest that industry fixed indexed annuity sales were down on a sequential basis. We believe low interest rates and the continuation of the equity bull market are the biggest headwinds for sales. We're not sure how much, if at all, implementation of the Department of Labor's fiduciary rule on June 9 affected the sequential decline in sales. Conversations surrounding the rule have been muted, particularly since the announcement of a potential further delay of certain aspects of the rule beyond January 1, 2018.

The market and each of our distribution channels remain competitive in the third quarter, although we saw several rate reductions in September. And a significant competitor in the independent agent channel lowered participation rates on its accumulation products and payout rates on its guaranteed income products in early October. Independent agents continue to shift their emphasis from guaranteed income to accumulation products focused on upside potential. We addressed this shift by placing more emphasis in our marketing efforts on our Choice Series at American Equity Life.

The Choice Series accounted for 22% of American Equity Life sales in the third quarter versus 17% in the second quarter. In September, it accounted for 25% of sales. We made changes to our lifetime income benefit riders in early July to recognize lower valuation interest rates used to compute statutory reserves for policies issued in 2017. We also discontinued our no-fee version of the rider, which was popular with our agents.

Many of our competitors did not make similar adjustments, which negatively affected our competitive position for guaranteed income, which was less than our significant competitors through much of the quarter. Due to the higher investment yields we have been capturing, we made several product changes in September and October: For the accumulation products, we raised participation and cap rates on American Equity's Choice and Eagle Life Select products. When coupled with the optional market value adjustment rider we introduced earlier this year, Choice 10 and Select 10 now offer some of the highest participation rates in the market among annual reset fixed indexed annuities. We believe these offerings compare very well with the proprietary index multiyear term products, which have been quite popular in the market. Rather than a proprietary index, our products contract value growth is based on the S&P 500, a transparent public index with 60 years of history that a policyholder can easily track.

We believe proprietary indices add another level of complexity to a safe money insurance product and do not offer a significant growth advantage. Higher investment yields also led us to improvements in our guaranteed income products. In September, we raised roll-up rates on our bonus products back to pre-July levels. In October, we introduced a new lifetime income benefit rider for our Foundation Gold fixed indexed annuity. Lifetime income on the Foundation Gold is very attractive, particularly in many important age deferral combinations where we expect it to offer higher guaranteed income than offered by our significant competitors.

Also, since we charge rider fees based on contract values rather than income account values, our fees are the lowest in the market, making Foundation Gold even more attractive on a net of fee basis. We are emphasizing to our agents that fees matter and that this should be an important factor when comparing annuities with lifetime income guarantees for their clients.

In addition, we're, again, offering the no-fee lifetime income rider on the Foundation Gold. We believe we are the best -- in the best competitive position, particularly at American Equity, than we have been since last year. However, we will continue to work on new products and features to enhance our competitiveness even further.

Turning to current sales trends. Pending business at American Equity Life averaged 2,196 applications during the third quarter and was 1,985 at the end of September compared to 2,206 applications when we reported second quarter 2017 earnings. Pending hit a low of 1,907 on September 7, but now stands at 2,178 applications. Pending at Eagle Life stands at 213 applications today, up from -- excuse me, 134 when we reported second quarter earnings.

As we noted in the past, sales momentum in the bank and broker-dealer channels tend to change much more quickly than in the independent channel.

Our distribution footprint at Eagle Life continues to grow in the third quarter. We added 1 new wholesaler, 3 new selling agreements and 513 representatives. In total, we have 9 wholesale and distribution partners, 58 selling agreements and 5,829 representatives.

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

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

Thank you, Ted and Ron. We are pleased with our third quarter results as spread and non-GAAP operating earnings, exclusive of the impact from revisions to actuarial assumptions and the loss on extinguishment of debt, remained stable despite continued headwinds from low interest rates. Although sales were down sequentially in the third quarter, we are pleased with the momentum at Eagle Life, which has carried over into the first part of the fourth quarter.

Regaining momentum at American Equity Life may take longer, but our products are now more competitive, and we believe that the value proposition we've always offered independent agents transparent products, attractive renewal crediting history and unparalleled service remains as attractive as ever.

We are optimistic that the Department of Labor will finalize the delay of the implementation of its fiduciary rule to July 1, 2019, and hopeful that regulations unduly burdening distribution of annuities by independent agents will be substantially revised. While the eventual outcome of the fiduciary rule remains uncertain, we remain prepared to respond and grow our business.

Our long-term outlook remains favorable due to the growing number of Americans who need attractive fixed indexed annuity products that offer principal protection with guaranteed lifetime income, and the fiduciary rule won't change this.

While we look to continue to expand our investment horizon, the credit quality of our investment portfolio will remain high and we will maintain our discipline of avoiding excessive credit risk. As we stated many times in the past, we offer sleep insurance. And that implies a promise to our agents and our policyholders that they can trust us to be there when they need their money, whether that be tomorrow or decades from now.

So on behalf of the entire American Equity team, thank you for your time and attention this morning. I'll now turn the call back to the operator for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Erik Bass with Autonomous Research.

Erik James Bass - *Autonomous Research LLP - Partner of US Life Insurance*

I had a question for Jeff, and I was just hoping that you could provide some more detail on the type of the assets that you're purchasing that have allowed you to increase the new money yield? And how you view the relative risk-reward on those assets?

Jeffrey D. Lorenzen - *American Equity Investment Life Holding Company - Executive VP & CIO*

This is Jeff. I'm not going to get into details of the specific securities, but in general, what we're doing is realigning the portfolio. We are looking more into structured asset segment of the market. What we've done is a deep-dive analysis looking through longer-term patterns of default and loss recoveries in different asset classes. And we're finding that certain structures within the structured assets and other segments of the market offer very attractive default and loss recovery profile, much better than what we might see on the corporate side, and is allowing us to shift into other asset classes where we can see some additional yield due to illiquidity or less liquidity. And you know our portfolio, we have ample liquidity, we have a very public open portfolio. And as a result, we felt we can take on several percent more of illiquidity and not have any impact to the portfolio.

Erik James Bass - *Autonomous Research LLP - Partner of US Life Insurance*

Got it. And I guess that we've seen a number of insurers that are talking about similar things of trading liquidity for yield and purchasing more structured securities, and certainly some spreads on those assets have come in. So I guess, how much value do you still see in this area of the market? And the spreads do become unattractive. Are there other avenues that you could pivot to, to meet the target returns -new money returns that you need for the new products?

Jeffrey D. Lorenzen - *American Equity Investment Life Holding Company - Executive VP & CIO*

We have seen spreads come in. We still think there's opportunities there. They do offer attractive value. Still at this point in time, we have several other asset classes that we're pursuing that could continue to offer some enhancements to yield that would offset any spread compression that we're seeing in other sectors.

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

Eric, this is John. One kind of follow-up to that too is, if yields do come in, because the space gets crowded, that's not going to just affect us. It's going to affect others looking to be in the same space. And I think consistent with our history, we would adjust product terms to reflect the investment yields we get, not just accept lower returns based upon potential declines in yields.

Erik James Bass - *Autonomous Research LLP - Partner of US Life Insurance*

Got it. That makes sense. And just can you quantify sort of how much more yield you need to achieve in terms -- I guess, to meet the target returns on the repriced products?

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

The product pricing that we're using reflects the target returns.

Erik James Bass - *Autonomous Research LLP - Partner of US Life Insurance*

Got it. So I mean, is it fair -- I think you are sort of just under 4% new money last quarter and now at 4.4%. So is that sort of, I guess, change in yield assumptions to think about?

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

The 4.4% supports the crediting rates that we have on products today, crediting rates and lifetime income rider terms.

Operator

Our next question comes from the line of Randy Binner with B Riley.

Weston Clay Bloomer - *FBR Capital Markets & Co., Research Division - Associate*

This is Weston Blommer on for Randy. Pending counts have trended lower over the past few quarters, perhaps some changes to the competitive environment and change to the income benefit rider. Do you guys feel like that has stabilized? And generally speaking, I'd expect pending counts to accelerate in the fourth quarter. Do you still expect that to be the case, or is this maybe just delayed a bit?

Ronald J. Grensteiner - *American Equity Investment Life Holding Company - President of American Equity Investment Life Insurance Company*

This is Ron. As I reported, pending did dip lower than typical in September, but we're starting to see it rebound. I think the rebound is due to us increasing our competitiveness by capturing that higher yield, raising some participation rates, increasing some income and some of our competitors backing off on some of their terms have helped us as well. So we're really in a competitive position today, but I can't predict what the fourth quarter is going to look like for pending.

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

This is John. I wouldn't necessarily consider fourth quarter seasonally -- seasonably up. I mean, it's happened that way in the past, but that's not necessarily always the case.

Operator

Our next question comes from the line of Kenneth Lee with RBC Capital Markets.

Kenneth S. Lee - *RBC Capital Markets, LLC, Research Division - Analyst*

So I just had a question in terms of the competitive activity. It sounds as if some competitors might be lowering some benefits on accumulation and guaranteed income products. And at the same time, you guys are changing terms as well, September, October. Just want to get a clear sense, at this point, how do AEL's products stack up versus competitors? Is this sort of like the most competitive versus close to the top? Any kind of color there?

Ronald J. Grensteiner - *American Equity Investment Life Holding Company - President of American Equity Investment Life Insurance Company*

Well, when we look at -- this is Ron. When we look at accumulation-type products, that's our Choice 10, for example, we have perhaps the highest, if not -- close to the highest, if not the highest participation rate out there on our 10-year chassis. It's a 52% participation rate on an annual reset. So that's attracting some good attention. So participation rate is very competitive. When you look at our caps, we're certainty in the hunt, but we're not the highest on caps. When you look at our income, we did make some great strides on improving our guaranteed income, particularly in October when we introduced a new version of the rider on our Foundation Gold. When we look at our top competitors, and when I say top competitors, those that will stay in the top 10, we don't have the highest guaranteed income. But when you look at our peer group or our fiercest competitors, for a lack of better word, we're right there even with them, and in a lot of cases, higher than them on guaranteed income. So we really feel like we're in the best place we've been for some time.

Kenneth S. Lee - *RBC Capital Markets, LLC, Research Division - Analyst*

Okay. Great. And then in terms of the potential to further lower the cost of money, in terms of the competitive activity, should we expect any kind of constraint on how much further you could lower the cost of money just based on the increased level of competitive activity?

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

Can I think we -- this is Ted. I think we've said in the past, we have a very really -- a really good renewal rate history out there in the marketplace. It is somewhat difficult sometimes to be able to see what competition has done with their renewal rates. I don't think our constraint is necessarily around what competition has done. It's purely more of a factor of us managing our spread and where we're at with that in regards to renewal rates. And currently, where we're at with yield, we're optimistic that right now, we're okay with where we're at with renewal rates.

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

This is John. And one follow-up on that, I know we've said on several occasions in the past that the competitive environment for new money is a very open and everybody sees what everybody else is doing. But on renewal rates, that competitive history is not part of really the competitive environment. We certainly trumpet to the field force, of very what we think is an attractive renewal rate crediting history. But that's not an element of competition, I don't think, among the carriers or something the agents look very closely at.

Kenneth S. Lee - *RBC Capital Markets, LLC, Research Division - Analyst*

Okay, very helpful. And just one last follow-up. Just what was mentioned earlier, in terms of the realigning of the investment portfolio, should we read that as something more like repositioning existing investments? Or is this sort of like just, once again, focused on mainly the new money side?

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

Right now, that focus is on the new money side. There's not been any realignment of the existing portfolio.

Operator

Our next question comes from the line of Pablo Singzon with JPMorgan. Pablo, your line may be on mute.

Pablo Augusto Serrano Singzon - *JP Morgan Chase & Co, Research Division - Analyst*

So first question is for Ron. Given all the project -- the product changes you made, do you think there's still financial flexibility to make your products more competitive if competitors respond in kind? Or do you think you've maximized potential changes for now?

Ronald J. Grensteiner - *American Equity Investment Life Holding Company - President of American Equity Investment Life Insurance Company*

We're always -- Pablo, we're always looking for opportunities to become more competitive. There's things that we can do. For example, on our guaranteed lifetime income, the longer you guarantee the roll-up period, the -- your income amount may be lower in those early years. But if you shortened the roll-up period, say, from 20 years to 10 years, we're able to offer a higher guaranteed income during that 10-year. So we could say, well, let's just do a 5-year guarantee and that could increase our income even more. So we always have to look at the levers that we have available to move and what's the competition doing. And so to answer your question, I wouldn't say we've maximized our opportunity. We're always looking for ways to get better.

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

Pablo, this is Ted. With pricing on products, it always starts with the opportunities that are available to invest new money. So it really -- that's where it starts and with the returns that we are targeting on our products. And so certainly, the opportunities to make our products more competitive always starts with the opportunities to be able to invest that money and what yields we can invest at and always stay in price discipline and making sure that we're targeting the appropriate returns. We feel that where we're at right now and the yield we're obtaining has allowed us to, as Ron has already said, position ourselves very, very competitively within the -- in the marketplace. And we'll continue to look at opportunities or ways that we can structure products to continue to make ourselves competitive out there. The marketplace is dynamic. People make rate changes. Where we're at right now, we're very competitive and will respond appropriately as we see competition make changes.

Pablo Augusto Serrano Singzon - *JP Morgan Chase & Co, Research Division - Analyst*

Got it, okay. And my follow-up is, so one of your competitors recently announced their insurance (inaudible) for sales through banks and brokers. Do you expect more companies to use similar structures? And how do think that changes competitive dynamics in that market for you?

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

I would expect they're going to be -- continue that people will look at onshore companies that don't have the tax efficiencies of the offshore platform, will continue to look for opportunities like that. Obviously, we've been utilizing that opportunity ourselves with our relationship with Athene through Eagle Life and able to allow us to have some profit-sharing or sharing in some of the efficiencies they have with their offshore platform. So it wouldn't surprise me that you will see other companies out there outside of us and Lincoln look for those opportunities.

Operator

(Operator Instructions) Our next question comes from the line of Alex Scott with Goldman Sachs.

Taylor Alexander Scott - *Goldman Sachs Group Inc., Research Division - Equity Analyst*

So this one is on just how you think about the required capital for new business? And just given some of the shifts in the way that you're investing new money kind of in the context of your asset leverage being a bit higher than peers, would you need to sort of think about asset leverage being lower on new business? Would that need to kind of come down over time as you execute this?

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

As we execute investing new money with a slightly different investment strategy, as we price products, we have to take that in consideration in regards to the capital ratios that we would be targeting. So that is being taken into consideration. I don't know if that's answering your question.

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

But the real answer is, there hasn't been that much shift in the required capital in terms of the investments we're buying. And maybe we got a little bit more Class 2s than we have Class 1s. But I think I looked and we went from 64 to -- there was a 1 percentage point change in -- between Class 1 and Class 2, 1 down and Class 2 up. So we really haven't done much to alter the capital requirements in the business.

Operator

I'm showing no further questions at this time, I'd like to turn the call back to Ms. LaFollette for any closing remarks.

Julie L. 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, thank you for your participation in today's conference. This concludes the program, and you may now disconnect. Everyone, have a great day.

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