

**MEMORANDUM**

November 14, 2008

To: File No. S7-14-08

From: Scott H. Kimpel  
Bradley J. Bondi  
Office of Commissioner Troy A. Paredes

Re: Indexed Annuities and Certain Other Insurance Contracts

On November 12, 2008, Scott H. Kimpel and Bradley J. Bondi, Counsel to Commissioner Troy A. Paredes, met with the following representatives of American Equity Life Holding Company: Kevin R. Wingert, President, John Matovina, Vice Chairman, and Wendy L. Carson, Chief Financial Officer and General Counsel. David E. Franasiak and Joel G. Oswald of Williams & Jensen, PLLC, counsel to American Equity Life Holding Company, also attended. The participants discussed proposed rule 151A. The representatives of American Equity Life Holding Company also provided the accompanying discussion materials.

Attachments



West Des Moines, IA 50266

# American Equity Investment Life Holding Company

## Proposed Rule 151A

## **Fixed Index Annuities = Fixed Annuities**

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West Des Moines, IA 50266

- **Fixed Index Annuities (“FIA’s) are fixed annuities.**
- **The 151A release incorrectly equates the purchase of an FIA with an investment in a market index.**
- **The only difference between a traditional declared rate annuity and an FIA is the manner in which annual interest is calculated.**
- **In both cases, full contract value, including premium plus interest credited in all prior years, is exposed to no investment risk.**

# Comparison of Annuities



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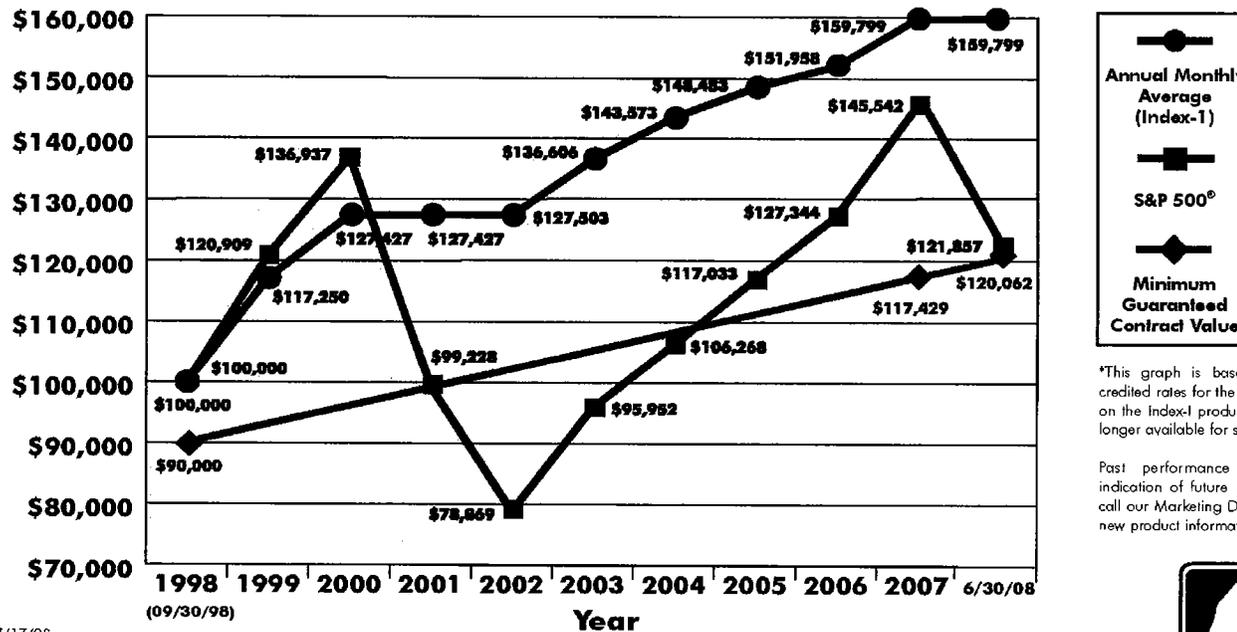
	<b>Declared Rate Annuity</b>	<b>Fixed Index Annuity</b>
<b>Guarantee of premium and minimum interest</b>	✓	✓
<b>Annual interest at rates declared by the insurer</b>	✓	
<b>Annual interest linked to an external index</b>		✓
<b>Tax-deferred growth</b>	✓	✓
<b>No up front sales charges or annual fees</b>	✓	✓
<b>Penalty-free 10% annual withdrawals starting in yr 2</b>	✓	✓
<b>Penalty-free systematic interest withdrawals</b>	✓	✓
<b>Surrender charges apply for withdrawals above 10%, waived at death</b>	✓	✓
<b>Additional liquidity upon nursing home confinement or terminal illness</b>	✓	✓

# Understanding FIA Contract Values



## The "REAL BENEFITS" of Indexed Annuities with the Annual Reset Design

A history of American Equity's Index-1\*  
(9/30/98 - 7/17/08)



\*This graph is based on actual credited rates for the period shown on the Index-1 product which is no longer available for sale.

Past performance is not an indication of future results. Please call our Marketing Department for new product information.



8109 07/17/08

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## **Marketing/Consumer Demand**

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- **The 151A release incorrectly states that FIA's are marketed and purchased primarily for market gains.**
- **FIA's are marketed and purchased primarily for safety of premium.**
- **FIA's offer consumers the opportunity to earn a somewhat higher interest rate than would be paid on a declared rate product.**

## Consumer Investment Risk

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- **The 151A release mistakenly states that an FIA purchaser assumes investment risk comparable to a variable annuity or mutual fund.**
- **FIA investment risk is limited to fluctuations in annual interest.**
- **Many insurance and bank products not regulated as securities have fluctuating levels of annual interest – including e.g. indexed certificates of deposit (prong 1 of 151A).**
- **Many insurance products not regulated as securities provide for “excess value” above guaranteed minimums (prong 2 of 151A).**

# Insurer Investment Risk

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- Fixed annuity insurers manage their “general account” securities to fund guaranteed FIA contract values.
- None of the risk of loss on general account securities is passed through to consumers.
- Variable annuities are “separate account” products where all investment experience of securities within the account is passed through to consumers, whether gain or loss.

# Insurance Regulation of Sales Practices

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- **The 151A release incorrectly states that the main focus of state insurance regulation is insurer financial solvency.**
- **State insurance regulation also covers (with some variation by state):**
  - Annuity disclosure requirements
  - Suitability reviews
  - “Free-look” periods
  - Advertising
  - Unfair trade practices
  - Regulation of “replacements”, or exchanges of annuities
  - Market conduct reviews of insurers
  - Levels of consumer guarantees in annuities/surrender charges
  - Agent licensing and training (specific FIA training in some states)
  - Insurance agent penalties for violations of sales rules

## **Complaints/Abusive Sales Practices**

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- **The 151A release incorrectly states that complaints and abusive FIA sales practices are sharply increasing.**
- **NAIC complaint data shows fewer complaints regarding FIA's than VA's or other types of annuities.**
- **NASAA maintains no complaint data.**
- **The NBC Dateline segment on FIA's featured only one actual consumer.**

# Protection of the Elderly

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- **The 151A release incorrectly states that fraud and abuse in sales to the elderly are closely linked to FIA's.**
- **Securities regulation has been no more and no less effective than state insurance regulation in protecting seniors from unscrupulous sales practices in sales of financial products.**
- **State insurance regulators are implementing new and enhanced protections for seniors, just as securities regulators are.**

# American Equity

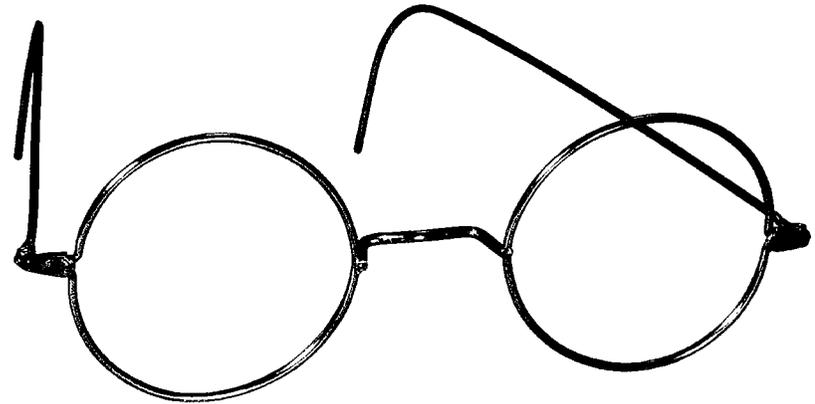
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- **No American Equity policyholder has ever lost a dime of contract value as a result of market volatility.**
- **American Equity requires the use of clear and concise disclosures in all sales in all states.**
- **American Equity conducts suitability reviews of all sales in all states.**
- **American Equity has a complaint ratio of less than 0.2% of all policyholders.**
- **American Equity trains its agents in suitability and disclosure in FIA sales.**

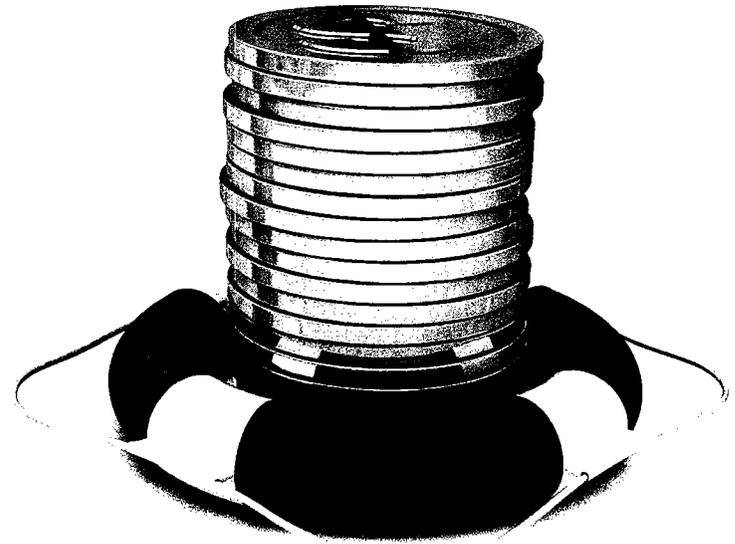
# **Fixed Indexed Annuities Fiction vs. Fact**



**Coalition for Fixed Products**

**FICTION: People buy FIAs for higher investment returns**

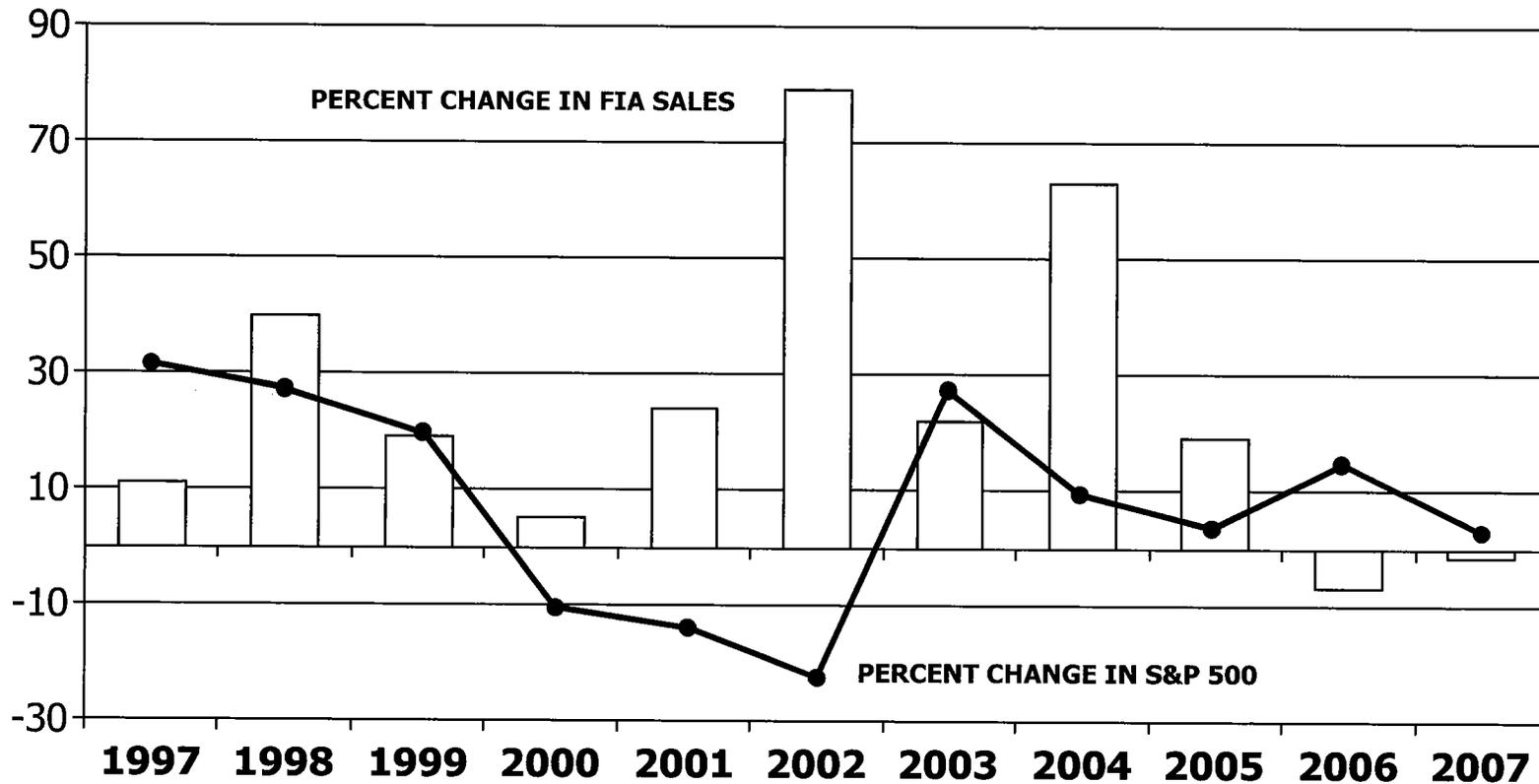
**FACT: People buy FIAs for safety of principal**



# **FACT: People buy FIAs for safety of principal**

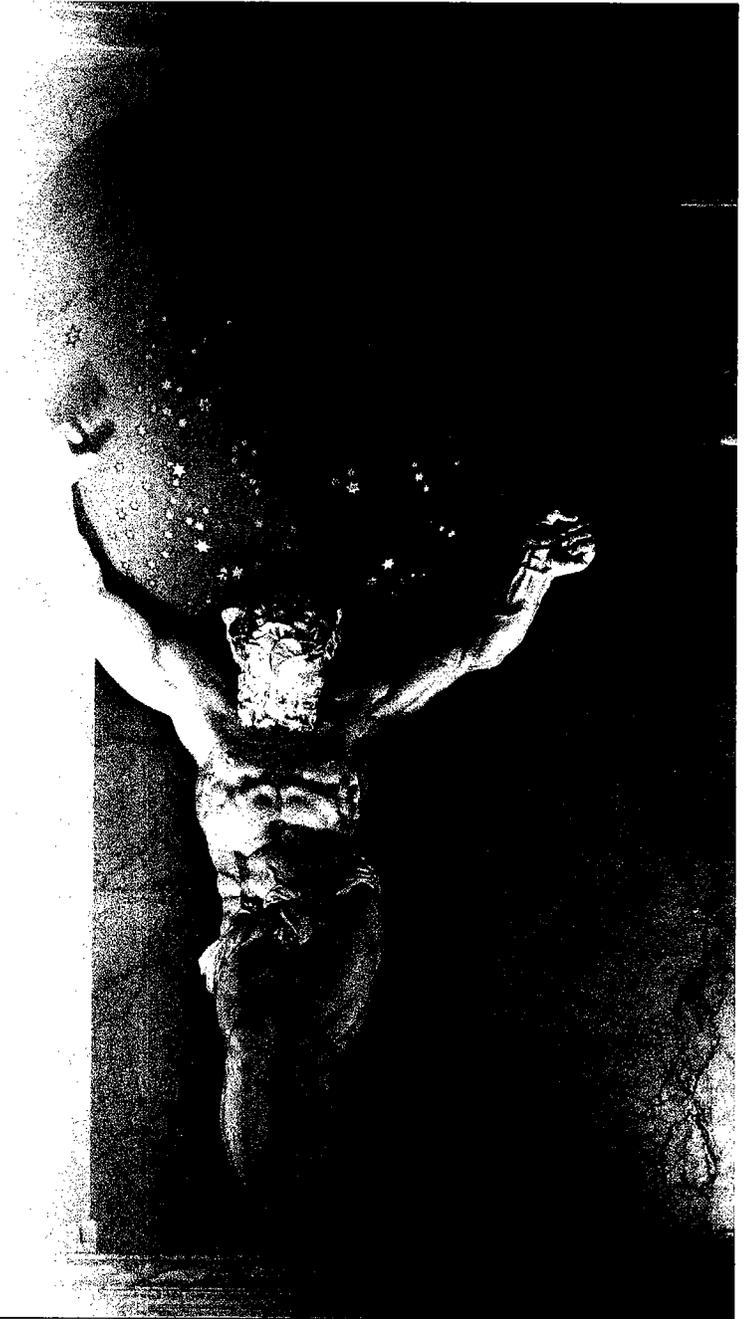
- Vast majority of FIA applicants say they buy FIAs to preserve principal or for guarantees—not to maximize returns
- History shows inverse relationship between FIA sales and S&P 500 returns (sales go up when people worry about losing money in market)
- Suze Orman: “for those who do not want to take any downside risk, the index annuity can be a good option”

# When markets are down, FIA sales tend to go up (people seek protection for their money)



**FICTION: FIA policyholders  
assume investment risk**

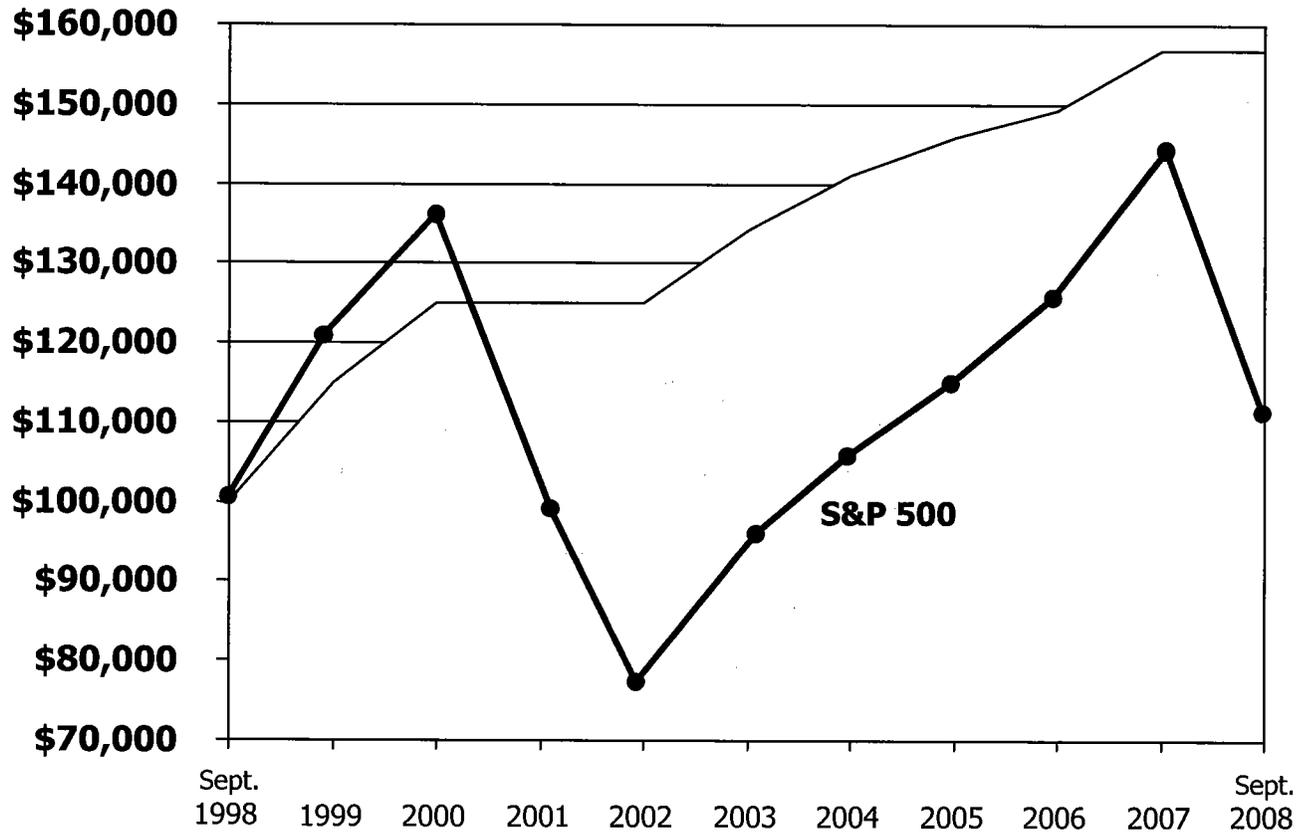
**FACT: Insurers  
bear entire  
investment risk**



# **FACT: Insurers bear entire investment risk**

- When market volatility wiped out \$2 trillion of retirement savings, FIA policyholders did not lose a penny
- Policyholder account values can never go down—even when indexes fall
- Insurers required to maintain risk-based capital at same level as traditional fixed annuities

# FIA values climb over time—even when markets are down



## 10-year history of an actual FIA

Performance of a real annual monthly-average FIA; results vary based on contract terms

**FICTION: Consumers can lose money  
on FIAs**

**FACT: Consumers  
cannot lose money  
if they hold FIAs  
through contractual  
surrender charge  
period**



# **FACT: Consumers cannot lose money if they hold FIAs through contractual surrender charge period**

- Virtually every FIA today provides guaranteed floor; values can only go up
- Like many other long-term savings vehicle (CDs, class-B mutual funds, IRAs), there are penalties for early withdrawal
- Every state has “non-forfeiture” requirements that say annuity values (other than variable annuities) must increase over time

# Surrender charges are clearly disclosed

## What happens after I die?

If you die before we start to pay you, income from your annuity, your beneficiary can choose to get the accumulation value of your annuity as one payment or as a series of payouts over time. If you die after payouts start, depending on the type of payout you chose, we pay the remaining value in the annuity, if any, to your beneficiary.

surrender charge if you make the exchange during the first seven years you own the annuity. Also, you may pay a surrender charge if you make withdrawals from the new annuity during the first years you own it.

## Does buying an annuity in a retirement plan provide extra tax benefits?

Buying an annuity with an IRA, 401(k), or other tax-deferred retirement plan doesn't give you any extra tax benefits. Choose your annuity based on its other features and costs. Please call us to learn more about this.

## FEES, EXPENSES & OTHER CHARGES

### What happens if I take out some or all of the money from my annuity?

When you take money from your annuity, you may receive some or all of your credited interest. If you take out all or part of the annuity, you may have to pay a surrender charge. The amount of the charge depends on how long you had the annuity and how much you withdrew. Here's how the surrender charges are calculated:

Contract year	1	2	3	4	5	6	7
Surrender charge	10%	9%	8%	7%	6%	5%	4%

Example: After two years, you've paid \$10,000 in premiums. You want to withdraw \$1,100 from your annuity in the third year. Since \$1,100 is more than 10% of the premium you've paid (\$10,000 x 0.10 = \$1,000), your surrender charge is \$1,100 x 0.09 = \$99. There's no surrender charge after the end of the seventh contract year.

When you make a withdrawal, we also may increase or decrease the amount you receive based on a market value adjustment (MVA). If interest rates went up after you bought your annuity, the MVA likely will decrease the amount you receive. If interest rates went down, the MVA likely will increase the amount you receive.

### Do I pay any other fees or charges?

No. There aren't any other fees or charges on this annuity.

## TAXES

### How will payouts and withdrawals from my annuity be taxed?

This annuity is tax-deferred, which means you don't pay taxes on the interest it earns until the money is paid to you. When you take payouts or make a withdrawal, you pay ordinary income taxes on the earned interest. You also pay a 10% federal income tax penalty on earnings you withdraw before age 59 1/2. If your state imposes a premium tax, it will be deducted from the money you receive.

You can exchange one tax-deferred annuity for another without paying taxes on the earnings when you make the exchange. Before you do, compare the benefits, features, and costs of the two annuities. You may pay a

Contract year	1	2	3	4	5	6	7	8+
Surrender charge	10%	9%	8%	7%	6%	5%	4%	0

If we do, we'll tell you about the changes in writing.

- We pay the agent, broker, or firm for selling the annuity to you.
- Many states have laws that give you a set number of days to look at an annuity after you buy it. If you decide during that time that you don't want it, you can return the annuity and get all your money back. Read your contract (page xi) to learn about your free look period.

### What should I know about the insurance company?

XYZ Life Insurance Company offers a wide variety of retirement and financial security products, including life insurance, annuities, long-term care, and disability income insurance. We also are a leading provider of products and services to workplace-based pension plans—both defined contribution and defined benefit plans. Our financial strength ratings are: A+ (A.M. Best), AA (S&P), Aa3 (Moody's), and AA- (Fitch).

XYZ Life Insurance Company  
123 Main Street  
Your Town, USA  
Telephone: 800-123-4567  
<http://www.xyzlife.com>



Standard FIA disclosure form developed by the American Council of Life Insurance; actual surrender charges vary by contract

**FICTION: State insurance regulation focuses only on insurer solvency**

**FACT: State insurance regulators are equally focused on consumer protection**

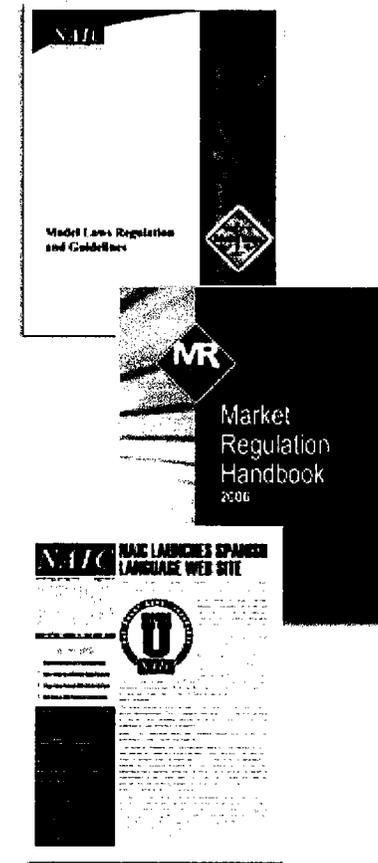


# **FACT: State insurance regulators are equally focused on consumer protection**

- State insurance laws include Suitability, Free Look Periods, Annuity Disclosure Requirements, Advertising, Unfair Trade Practices, and Agent Licensing and Training
- State insurance departments nationwide employ over 600 workers in Market Conduct Regulation (including market conduct examiners and analysts) and over 1600 workers in Consumer Affairs (including consumer investigators and consumer advocates)
- In 2007, state insurance departments levied over 400 fines and 300 restitutions against insurance agents, suspended nearly 16,000 agent licenses, and revoked about 1400 licenses

# NAIC model laws and regulations

- Suitability in Annuity Transactions Model Regulation (or related legislation): enacted in 41 states
- Annuity Disclosure Model Regulation: enacted in 22 states
- Insurance and Annuity Replacement Model Regulation: enacted in 43 states
- Unfair Trade Practices Act: some version enacted in every state



**FICTION: FIAs are too complicated for consumers to understand**

**FACT: FIAs are no more complex than other common financial products (and less so than variable contracts and mutual funds)**



# **FIAAs are no more complex than other common financial products (and less so than variable contracts and mutual funds)**

- FIAs allow consumers to make a few basic choices—type of index (e.g., S&P 500), method of crediting (e.g., point to point), and possible riders (e.g., income rider)
- FIA base contract has no loads or annual fees; consumers pay charges only if they surrender early
- By contrast, variable contracts and mutual funds involve highly complex decisions about type of fund (stock, bond, domestic, foreign, large cap, small cap), investment style (growth, value, active, passive, tax-managed), fees and charges (sales charges, 12b-1 fees, management and administrative fees), managers (investment advisor, sub-advisors, service providers), multiple risk factors (market performance, credit risks, exchange rates, interest rates)

# Prospectuses are no panacea

1,200 adults surveyed about financial literature

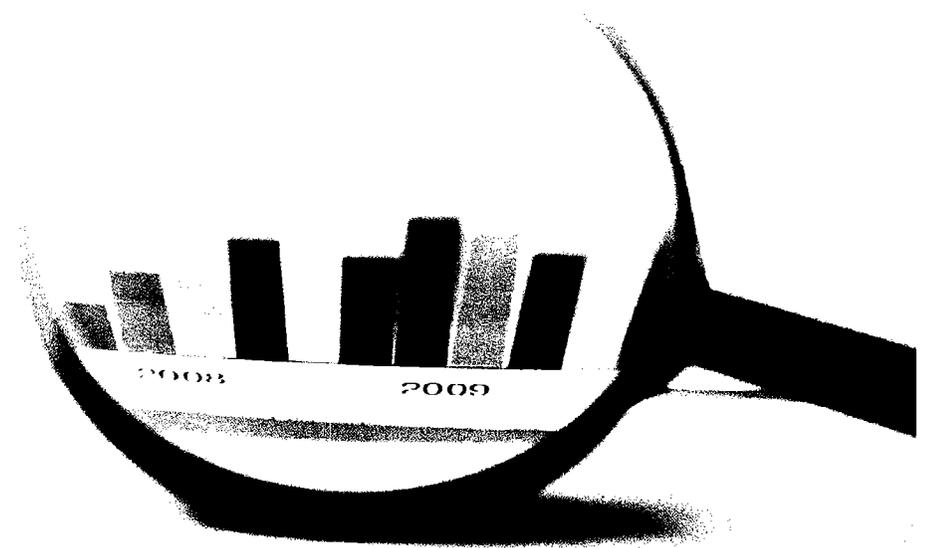
## "Which is easier to understand?"

<b>Mutual fund prospectus</b> Instructions for your computer	23% 69%
<b>Mutual fund prospectus</b> IRA tax forms	33% 58%
<b>Mutual fund prospectus</b> Your car insurance policy	13% 82%
<b>Mutual fund prospectus</b> Inserts that come in prescription drugs	16% 79%

Source: AARP  
Financial Inc., 2008

**FICTION: FIAs are the source of lots of complaints**

**FACT: Recorded FIA complaint levels are relatively low**



# **FACT: Recorded FIA complaint levels are relatively low**

- NAIC statistics: complaints involving FIAs numbered 105 in 2005, 231 in 2006, and 248 in 2007, representing about 0.1% of all complaints received by insurance departments on all insurance lines
- According to a reputable industry analyst, percentage of FIA owners who have never complained is 99.7% or higher
- Critics of FIA products—especially in securities industry—have never produced statistics to support allegations of an increase in “complaints of abusive sales practices” for FIAs, despite repeated requests for such information

# Compare FIAs to securities-regulated variable products...

"A perennial fixture on NASAA's list of top scams involve the sale of variable annuities to investors with little regard to whether or not the product is suitable."

— Testimony of Patricia D. Struck, President  
North American Securities Administrators Association  
U.S. Senate Special Committee on Aging  
March 29, 2006



## TESTIMONY OF PATRICIA D. STRUCK

Wisconsin Securities Division Administrator  
and  
President  
North American Securities Administrators Association, Inc.

Before the  
Special Committee on Aging  
United States Senate

Protecting Senior Citizens Against Financial Fraud

March 29, 2006

# Sources

- **Page 3:** Suze Orman, *The Road to Wealth*, Riverhead Books, 2008, pg. 512
- **Page 4:** Data from IndexAnnuity.org, published by Jack Marrion, Advantage Compendium, Ltd., 2008
- **Page 6, Bullet 1:** \$2 trillion loss from 4/2007 to 9/2008 —Presentation of Peter Orszag, head of Congressional Budget Office, to House Education and Labor Committee, reported by *USA Today*, October 8, 2008; **Bullet 2:** NAIC risk-based capital requirements for life insurers—C-4 business risk factor is 0.08% of liabilities for variable annuities and 3.08% for fixed annuities including FIAs; see 2007 NAIC Life Risk-Based Capital Report, pg. 63
- **Page 7:** Performance of actual monthly average FIA based on performance of S&P 500 subject to then current caps and participation rates; interest crediting methods, caps, spreads, and participation rates vary by product; while representative of FIA performance, illustration is not reflective of all FIAs and future results may vary; FIAs are insurance products backed by the financial strength of the issuing company; FIAs do not own underlying securities and indices are exclusive of dividends
- **Page 9:** Non-forfeiture requirement applies in all 50 states: see ACLI Law Survey, “Fixed Annuity Non-forfeiture Interest Rate”; also see individual state certification statements for non-forfeiture standards
- **Page 10:** Form produced by American Council of Life Insurers and NAVA, Inc. (Association for Insured Retirement Solutions), *Improving Annuity Disclosure, A Life Insurance Industry Initiative*, 2008, page 21
- **Page 12, Bullets 2 and 3:** NAIC 2007 Insurance Department Report, pp. 9–11
- **Page 13: Bullet 1:** ACLI Issue State Chart on NAIC Annuity Disclosure & Suitability dated 10/17/08; **Bullets 2 and 3:** NAIC officers letter to SEC Chairman Christopher Cox dated 9/10/08
- **Page 16:** AARP Financial Inc., [www.moneysmarts.com](http://www.moneysmarts.com), 2008
- **Page 18, Bullet 1:** Statistics derived from National Association of Insurance Commissioners Consumer Information Source (CIS) Complaints Database System as posted on NAIC website, 2008; **Bullet 2:** [www.IndexAnnuity.org](http://www.IndexAnnuity.org), published by Jack Marrion, Advantage Compendium, Ltd., posted April 2008

**From:** David E. Franasiak  
**Sent:** Friday, November 14, 2008 11:06 AM  
**To:** Bondi, Bradley J.; Kimpel, Scott H.  
**Subject:** Analysts reports from June 25 - SEC 151A

Thank you for meeting with American Equity Life on Wednesday. Here is the information you requested. If you have any questions, please give me a call.

<<FPK 6-27-08.pdf>> <<RJ 6-26-08.pdf>>

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# American Equity Investment Life

In Line

AEL

USD8.01\*

Analyst(s): Mark Finkelstein

Mark.Finkelstein@fpk.com

312 425 4079

## Lowering Ests On Challenged Outlook For Index Annuities

Data	
52-week range (USD)	7.06-12.50
Price Target (USD)	na
Upside/downside to price target (%)	na
Market cap (USDm)	437.3
Dividend (USD)	na
Dividend Yield (%)	na

Performance (%)				
	1W	1M	3M	YTD
Price performance	-29.9	-24.4	-17.0	-3.4
Rel. S&P 500	-28.0	-18.4	-14.2	10.6
Rel. FPKCCW Life Insurance	-24.5	-14.4	-10.1	22.5

Operating EPS (USD)			
Quarterly EPS breakdowns			
	2007	2008e	2009e
1Q	0.26	0.31 a	na
Consensus			0.34
2Q	0.28	0.33	na
Consensus		0.32	0.34
3Q	0.28	0.33	na
Consensus		0.35	0.35
4Q	0.29	0.34	na
Consensus		0.36	0.36
Annual	1.10	1.30	1.40
Consensus		1.33	1.45

- We are lowering our 2008 and 2009 estimates on AEL to \$1.30 and \$1.40 from \$1.37 and \$1.59, respectively, to reflect the SEC's rule that, if not overturned, would classify index annuities as securities and not insurance products and require these products to be distributed by securities licensed representatives. The basis for our EPS adjustment is higher expected legal costs, in anticipation of fighting the SEC action, costs associated with assisting / transitioning the agent force to securities licensed reps and a slightly lower sales forecast.
- While the costs of litigation / transition are unclear, we have judgmentally added \$0.02 of expenses each quarter commencing Q3'08 for these undertakings through 2009 and will refine these estimates as more information / strategies become more clear.
- While AEL and key constituents in the industry will contest vigorously this SEC action, this highly negative long-term consideration is now a very real possibility. Based on anecdotes, we assume around 30 percent of AEL's agent force is likely "dual licensed" to sell both securities and insurance products, suggesting the effort and associated risks to license the remainder of the sales force are sizeable. In addition to getting agents licensed, AEL will also likely need to revitalize its broker / dealer and enter into selling agreements with broker / dealers.
- Assuming the rule passes, the only likely reprieve the industry would get is time to facilitate this transition. We understand the SEC comment period will likely go into September with a 1-year implementation period, or implementation around Q4'09. For those agents that have "made their living" selling index products, this will give them time to get licensed and we would expect them to do so. We anticipate this is a good part of AEL's agent sales (about 60 percent of sales are from the top 600 agents). Nonetheless, it cannot be assumed all producing agents will get licensed, selling agreements can be arranged with other b/ds, and/or other outcomes that could occur from a different regulatory body that has been overtly critical of the index annuity product and sales practices. On the latter, we understand that the SEC's focus is mainly on acceptability of disclosures than on potential product structures.

Continued.

### Share price performance (USD)



\* Price as at close on Jun 26, 2008

Analyst certifications and required disclosures begin on page 4.

Fox-Pitt Kelton Cochran Caronia Waller on the Web: <http://www.fpk.com/x/publicresearchdisclosure.html>



We are lowering our sales forecast for 2008 and 2009 slightly to be conservative (5% for Q3 and Q4 2008 and 11.5% for all of 2009), even though the implementation period is likely not to go into effect until Q4'09. While this could actually cause some sales "acceleration" for certain agents promoting the product ahead of the changes, there may also be an increase in negative press on the product and other distractions, which could weigh on sales.

The fundamental outlook on AEL is clearly more negative, given that more than 90 percent of sales are effected by this ruling (index annuities, fixed rate annuities unaffected), and the impact of this action will weigh on the stock for the foreseeable future. The likelihood of a transition period helps to manage the situation. With the shares down 24% on June 26 and now trading at 0.6x book value, we are maintaining our In Line rating on AELshares, as we currently see the downside as largely in the stock at these levels.



	2006	2007Q1	2007Q2	2007Q3	2007Q4	2007	2008Q1	2008Q2E	2008Q3E	2008Q4E	2008E	2009E
Traditional life and accident & health premiums	13,622	3,057	3,190	3,344	3,032	12,623	3,316	3,062	3,210	2,911	12,499	11,874
% Change	0.3%	-13.3%	-0.7%	0.9%	-15.2%	-7.3%	8.5%	-4.0%	-4.0%	-4.0%	-1.0%	-5.0%
Annuity and single premium universal life product charges	39,472	8,994	11,453	12,576	12,805	45,828	12,098	12,723	13,022	13,368	51,211	56,252
% Change	53.7%	18.3%	6.6%	16.9%	23.4%	16.1%	34.5%	11.1%	3.5%	4.4%	11.7%	9.8%
% Opening Annuity Balance	0.37%	0.33%	0.40%	0.42%	0.41%	0.39%	0.38%	0.39%	0.39%	0.39%	0.39%	0.39%
Net Investment Income	677,638	169,358	175,719	183,732	191,107	719,916	195,488	199,355	203,971	208,304	807,119	875,924
% Change	22.2%	4.3%	3.9%	6.0%	10.6%	6.2%	15.4%	13.5%	11.0%	9.0%	12.1%	8.5%
Change in fair value of derivatives	33,794	17,862	68,821	56,332	(7,249)	135,766	(62,452)	0	0	0	(62,452)	0
% Change	-238.8%	-372.0%	820.8%	na	na	na						
Total Revenue	764,526	199,271	259,183	255,984	199,695	914,133	148,450	215,140	220,203	224,583	808,377	944,050
% Change	34.2%	19.4%	36.0%	41.2%	-11.5%	19.6%	-25.5%	-17.0%	-14.0%	12.5%	-11.6%	16.8%
Insurance Policy Benefits & Changes in future policy benefit	8,808	1,933	2,097	2,360	2,029	8,419	2,609	2,672	2,735	2,807	10,823	11,813
% Change	-34.1%	-19.4%	-7.6%	21.2%	-7.5%	-4.4%	35.0%	27.4%	15.9%	38.4%	28.6%	9.1%
% Annuity Premium	22.3%	21.5%	18.3%	18.8%	16%	18.4%	21.6%	21%	21%	21%	21.1%	21.0%
Interest credited to account balances	404,270	115,953	168,141	165,821	110,294.0	560,209	54,176	117,400.5	118,245.9	118,855.0	408,678	499,671
% Change	37.3%	38.7%	65.1%	91.5%	-16.6%	38.6%	-53.3%	-30.2%	-28.7%	7.8%	-27.0%	22.3%
Amortization of deferred sales inducements	27,492	7,748	9,124	9,177	9,364	35,413	10,595	11,119	11,471	11,868	45,053	50,745
% Change	69.3%	32.6%	38.8%	34.1%	13.8%	28.8%	36.7%	21.9%	25.0%	26.7%	27.2%	12.6%
% of Fund Balance	0.351%	0.09%	0.10%	0.09%	0.09%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
Interest expense on notes payable	15,541	3,820	3,793	3,770	3,772	15,155	3,638	3,626	3,648	3,669	14,581	14,794
% Change	6.5%	-2.9%	-3.0%	-4.8%	0.9%	-2.5%	-4.8%	-4.4%	-3.2%	-2.7%	-3.8%	1.5%
% Yield	5.6%	5.74%	5.72%	5.70%	5.7%	5.7%	5.48%	5.5%	5.6%	5.6%	5.5%	5.7%
Interest expense on subordinated debentures	21,354	5,589	5,614	5,673	5,644	22,520	5,231	5,461	5,516	5,640	21,848	23,411
% Change	51.0%	13.6%	3.9%	-2.1%	7.8%	5.5%	-6.4%	-2.7%	-2.8%	-0.1%	-3.0%	7.2%
% Yield	8.3%	8.3%	8.4%	8.5%	8.4%	8.4%	7.8%	8.1%	8.1%	8.2%	8.0%	8.3%
Interest expense on amounts due under repurchase agreements	32,931	4,018	3,060	4,764	4,084	15,926	2,972	3,425	3,026	2,947	12,370	11,607
% Change	191.9%	-31%	-64%	-57%	-46%	-51.6%	-26%	12%	-36%	-28%	-22.3%	-6.2%
% Yield	5.7%	5.2%	3.9%	5.4%	5.8%	5.0%	3.4%	5.2%	5.2%	5.2%	3.5%	3.5%
Amortization of deferred policy acquisition costs	101,100	25,656	28,405	27,776	27,712	109,549	29,587	30,481	32,018	33,446	125,531	141,233
% Change	26.5%	12.5%	16.1%	4.3%	1.9%	8.4%	15.3%	7.3%	15.3%	20.7%	14.6%	12.5%
% Revenues	13.2%	12.9%	11.0%	10.9%	13.9%	12.0%	19.9%	14.2%	14.5%	14.9%	15.5%	15.0%
% EGP (prior to DAC)	34%	34%	34%	35%	35%	35%	34%	34%	34%	34%	34%	34%
Other Operating Costs and Expenses	40,418	11,411	14,083	11,582	11,154	48,230	12,451	12,534	12,624	14,069	51,679	62,238
% Change	13.8%	12.1%	41.8%	21.6%	3.5%	19.3%	9.1%	-11.0%	9.0%	10.0%	7.2%	20.4%
Total Benefit and Expenses	651,914	176,128	234,317	230,923	174,053	815,421	121,259	186,717	191,083	195,102	694,161	821,512
% Change	35.2%	26%	44%	52%	-12%	25.1%	-31%	-20%	-17%	12%	-14.9%	18.3%
<b>Operating Income</b>	<b>112,612</b>	<b>23,143</b>	<b>24,866</b>	<b>25,061</b>	<b>25,642</b>	<b>98,712</b>	<b>27,191</b>	<b>28,423</b>	<b>29,120</b>	<b>29,481</b>	<b>114,215</b>	<b>122,538</b>
Tax on Operating Income	39,278	8,010	8,539	8,639	8,622	33,810	9,457	9,891	10,134	10,259	39,742	42,643
Tax Rate	34.9%	34.6%	34.3%	34.5%	33.6%	34.3%	34.8%	34.8%	34.8%	34.8%	34.8%	34.8%
<b>Net Operating Income</b>	<b>73,334</b>	<b>15,133</b>	<b>16,327</b>	<b>16,422</b>	<b>17,020</b>	<b>64,902</b>	<b>17,734</b>	<b>18,532</b>	<b>18,986</b>	<b>19,222</b>	<b>74,474</b>	<b>79,895</b>
Realized Gains on Investments	427	374	11	210	(2,283)	(1,688)	(1,008)				(1,008)	0
Net Effect of FIN 46	0	0	0	0	0	0	0				0	0
Net Effect of FAS 133	1,724	(5,580)	8,251	(9,235)	(19,735)	(26,299)	32,426				32,426	0
<b>Net Income</b>	<b>75,485.0</b>	<b>9,927</b>	<b>24,589</b>	<b>7,397</b>	<b>-4,998</b>	<b>36,915.0</b>	<b>49,152</b>	<b>18,532</b>	<b>18,986</b>	<b>19,222</b>	<b>105,892.0</b>	<b>79,894.9</b>
Total Weighted Shares Outstanding	55,693	56,693	57,122	56,878	56,348	56,760	55,431	54,805	54,861	54,282	54,845	54,392
Total Diluted Weighted Shares Outstanding	60,424	60,159	60,309	59,774	59,154	59,849	58,221	57,887	58,110	57,865	58,021	57,781
BVPS (Diluted, Ex FAS 115)	10.54	10.73	11.08	11.18	10.99	10.99	11.75	12.01	12.16	12.33	12.33	13.30
Net Income per share	1.25	0.17	0.41	0.12	(0.08)	0.62	0.84	0.32	0.33	0.33	1.83	1.38
<b>Operating EPS-diluted</b>	<b>1.23</b>	<b>0.26</b>	<b>0.28</b>	<b>0.28</b>	<b>0.29</b>	<b>1.10</b>	<b>0.31</b>	<b>0.33</b>	<b>0.33</b>	<b>0.34</b>	<b>1.30</b>	<b>1.40</b>
ROE ex FAS 115	12.5%	9.5%	9.9%	9.8%	10.3%	9.9%	10.6%	10.8%	10.8%	10.8%	10.8%	10.8%
Operating Margin	9.6%	7.6%	6.3%	6.4%	8.5%	7.1%	11.9%	8.6%	8.6%	8.6%	9.2%	8.5%
Operating Expenses, as % of average account value	0.38%	0.41%	0.48%	0.38%	0.36%	0.40%	0.39%	0.38%	0.37%	0.41%	0.38%	0.42%
<b>Calculated Spreads</b>												
Net Investment income	6.14%	6.06%	6.11%	6.09%	6.17%	6.14%	6.14%	6.15%	6.14%	6.13%	6.15%	6.13%
Crediting rate	3.42%	3.44%	3.35%	3.55%	3.47%	3.51%	3.56%	3.50%	3.44%	3.47%	3.47%	3.38%
Net Spread	2.73%	2.62%	2.76%	2.54%	2.49%	2.63%	2.58%	2.65%	2.70%	2.75%	2.68%	2.75%
* Note: spread may not correspond to company calculation												
Sales Inducements (included in interest credited)	27,491	7,748	9,124	9,177	9,364	35,413	10,595	11,119	11,471	11,868	45,053	50,745
% of Deferred Sales Inducements (Annualized)	6.9%	6.8%	7.2%	6.8%	6.4%	6.8%	6.9%	7.0%	7.0%	7.0%	7.0%	10.2%
<b>Net Fund Value</b>												
Index Annuities	8,764.3	9,162.7	9,764.7	10,297.9	10,750.8	10,750.8	11,118.7	11,470.8	11,868.2	12,179.6	12,179.6	13,425.1
% Change - IA	23%	20%	20%	23%	23%	23%	21%	17%	15%	13%	13%	10%
Single Year Fixed Rate Guaranteed Annuities	1,660.5	1,629.5	1,598.9	1,789.7	1,505.5	1,463.1	1,463.1					
Multi Year Fixed Rate Guaranteed Annuities	616.1	572.8	537.2	272.0	483.9	467.2	467.2					
Total Fixed Rate Annuities	2,276.6	2,202.3	2,136.2	2,061.7	1,989.4	1,989.4	1,930.2	1,885.1	1,842.6	1,800.6	1,800.6	1,647.0
% Change - Fixed	-24%	-24%	-17%	-15%	-13%	-13%	-12%	-12%	-11%	-9%	-9%	-9%
Est. Persistency/index growth (Fund Value - sales / P/Y Fund Value)	73.0%	71.5%	77.4%	82.4%	85.1%	85.1%	85.5%	86.0%	87.0%	88.0%	88.0%	88.0%
% Change	-24.3%	-24%	-17%	-15%	-13%	-12.6%	-12%	-12%	-11%	-9%	-9.5%	-8.5%
Total	11,040.8	11,365.0	11,900.9	12,359.6	12,740.2	12,740.2	13,048.9	13,355.9	13,710.9	13,980.3	13,980.3	15,072.0
% Change	9.1%	7.9%	11.2%	14.2%	15.4%	15.4%	14.8%	12.2%	10.9%	9.7%	9.7%	7.8%
<b>Annuity Deposits</b>												
Total Index Annuities	1,787.26	430.8	604.5	533.5	524.8	2,093.58	506.4	531.9	522.0	513.6	2,073.89	1,976.21
% Change	-33.5%	-20%	22%	54%	29%	17.1%	18%	-12%	-2%	-2%	-0.9%	-4.7%
Total Fixed Rate Annuities	82.71	13.7	18.0	10.3	9.1	51.11	8.8	19.9	11.3	10.0	49.92	62.40
% Change	-59.9%	-45%	-17%	-49%	-43.2%	-38.2%	-36%	10.0%	10.0%	10.0%	-2.3%	25.0%
Total before coinsurance ceded	1,870.0	444.5	622.5	543.8	533.9	2,144.7	515.2	551.8	533.3	523.5	2,123.8	2,038.6
Coinsurance ceded	2,859	0.591	0.484	0.386	0.318	1.779	0.537	0	0	0	0.537	0
Net After Coinsurance ceded	1,867.1	443.9	622.0	543.4	533.6	2,142.9	514.6	551.8	533.3	523.5	2,123.3	2,038.6
% Change	-35.4%	-21%	20%	49%	27%	14.8%	16%	-11%	-2%	-2%	-0.9%	-4.0%

Source: Company Reports, FPKCCW



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**American Equity Investment Life [AEL]**

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**Historical closing prices and rating/target prices**

AEL current rating is: In Line



Data source: FactSet prices/ FPK ratings and target prices

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**Ratings distribution and investment banking involvement**

Rating type	% of covered companies currently assigned this rating	% of companies assigned this rating with which FPK has provided investment banking services over the past 12 months
Buy [OP/UW; IL/OW]	37.0%	3.1%
Hold [OP/UW; IL/OW; IL/MW; IL/UW; UP/OW]	48.7%	2.5%
Sell [UP/MW; UP/UW]	14.3%	0.2%

**Ratings definition information**

**Global company rating definitions**

- Outperform (OP) We expect the stock to outperform its sector over the next 12 months
- In Line (IL) We expect the stock to perform in line with its sector over the next 12 months
- Underperform (UP) We expect the stock to underperform its sector over the next 12 months

**Global sector ranking definitions**

- Overweight (OW) We expect the sector to outperform the relevant market index over the next 12 months
- Marketweight (MW) We expect the sector to perform in line with the relevant market index over the next 12 months
- Underweight (UW) We expect the sector to underperform the relevant market index over the next 12 months



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# American Equity Investment Life Holding Company

(AEL:NYSE)

Downgrade

**Underperform 4**

West Des Moines, Iowa-based American Equity Investment Life Holding Company (AEL) is a growing, small-cap life insurance company specializing in the sale of traditional fixed rate and indexed annuities. The company markets its products through more than 52,000 independent agents and consistently ranks among the leading indexed annuity writers.

## AEL: Reducing Rating to Underperform Following Adverse SEC Proposal

- ◆ Following yesterday's SEC staff proposal to treat index annuities as investments, we are lowering our investment rating on shares of American Equity Investment Life to **Underperform** from our previous Outperform rating.
- ◆ While we believe the SEC staff proposal is flawed and will ultimately be overturned in the court system (if it indeed is ultimately accepted by the Board of Governors following the public comment period), we believe the issue itself will make it unlikely that the stock will be able to outperform the general life insurance group, in, at least, the near term.
- ◆ While we do not believe that sales will be affected over the next 15 months, sales could be negatively affected, possibly substantially, once any accepted rule becomes effective. (The SEC staff has suggested that any new rule become effective 12 months after its adoption). We believe that American Equity will work diligently to help its agents to become securities registered and to develop new products for those agents that remain unregistered.
- ◆ We believe the company will immediately seek injunctive relief if and when the proposal becomes an official ruling. However, the timing of any injunctive relief, if granted at all, is highly uncertain and could take a year or longer. Ultimately, we believe an official ruling based on today's staff proposal will end up decided in the U.S. Supreme Court.
- ◆ Reflecting our best guesstimate of costs associated with the registration effort, we have lowered our earnings estimate by roughly \$0.03 per share for the fourth quarter of 2008 and the first three quarters of 2009 apiece. Our new non-GAAP operating EPS estimates for 2008 and 2009 are \$1.34 and \$1.44, respectively.
- ◆ For more information regarding the SEC Staff proposal, please see our report "SEC Staff Proposal: Index Annuities Should be Considered Securities" published earlier today.

Non-GAAP							GAAP EPS
EPS	Q1	Q2	Q3	Q4	Full	Full	
FY= Dec	Mar	Jun	Sep	Dec	Year	Year	
2007A	\$0.26	\$0.28	\$0.28	\$0.29	\$1.10	\$0.50	
Old 2008E	0.31A	0.33	0.35	0.37	1.37	1.91	
<b>New 2008E</b>	<b>0.31A</b>	<b>0.33</b>	<b>0.35</b>	<b>0.35</b>	<b>1.34</b>	<b>1.88</b>	
Old 2009E	0.37	0.38	0.38	0.39	1.52	1.52	
<b>New 2009E</b>	<b>0.34</b>	<b>0.35</b>	<b>0.35</b>	<b>0.39</b>	<b>1.44</b>	<b>1.44</b>	

Rows may not add due to rounding. Non-GAAP EPS reflects GAAP EPS less realized gains & losses on investments, non-operating benefits & charges, and discontinued operations.

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## EQUITY RESEARCH

June 26, 2008

Life and Health Insurance Company Comment

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**Current Price**  
 (6/25/2008 ) \$10.58  
 Projected 12-Month Target Price: NM

**52-Week Range** \$12.55-\$6.82  
 Dividend/Yield \$0.06/0.6%  
 Book Value (03/08) \$11.56  
 Suitability Not Meaningful

**Shares Out. (mil.)** 54.0  
 Market Cap. (mil.) \$571  
 Avg. Daily Vol. (10 day) 719,530

**Proj. 3-Yr EPS Growth Rate** 10%  
 ROE 12%  
 LT Debt (mil.)/% Cap. \$531/44%

**P/E Ratios (Non-GAAP)**  
 2008E 7.9x  
 2009E 7.3x

**Revenues (mil.)**

	Old	New
2007A	\$778	\$778
2008E	\$877	\$877
2009E	\$970	\$972

American Equity Investment Life	Q1 07	Q2 07	Q3 07	Q4 07	2007	Q1 08	Q2 08E	Q3 08E	Q4 08E	2008E	Q1 09E	Q2 09E	Q3 09E	Q4 09E	2009E
<i>(\$ in thousands)</i>															
<b>Revenues:</b>															
Trad life and accident/health premiums	3,057	3,190	3,344	3,032	12,623	3,316	3,316	3,316	3,316	13,264	3,316	3,316	3,316	3,316	13,264
Annuity and single premium UL product charges	8,994	11,453	12,576	12,805	45,828	12,098	13,241	14,490	14,815	54,644	14,092	14,693	15,948	16,288	61,021
Net investment income	169,358	175,719	183,732	191,107	719,916	195,488	198,885	204,298	210,022	808,693	214,858	221,863	227,343	233,172	897,236
<b>Total Revenues</b>	<b>181,409</b>	<b>190,362</b>	<b>199,652</b>	<b>206,944</b>	<b>778,367</b>	<b>210,902</b>	<b>215,442</b>	<b>222,104</b>	<b>228,153</b>	<b>876,601</b>	<b>232,266</b>	<b>239,872</b>	<b>246,607</b>	<b>252,776</b>	<b>971,521</b>
<b>Benefits and expenses:</b>															
Policy benefits and change in future policy benefits	1,933	2,097	2,360	2,029	8,419	2,609	2,609	2,609	2,609	10,436	2,609	2,609	2,609	2,609	10,436
Interest credited to account balances	105,897	108,500	118,725	126,907	460,029	127,223	129,797	131,713	133,923	522,656	137,453	142,084	146,558	150,559	576,654
Interest expense on notes payable	0	0	0	31	31	0	0	0	0	0	0	0	0	0	0
Interest expense owed to American Equity Capital Trust I and II	5,531	5,558	5,614	5,644	22,347	5,231	4,994	4,911	4,911	20,047	4,911	4,911	4,911	4,911	19,644
Interest expense on general agency commission and servicing agreement	346	320	294	265	1,225	233	198	163	128	722	93	58	23	-12	162
Interest expense on amounts due under repurchase agreements	4,018	3,060	4,764	4,084	15,926	2,972	1,590	1,590	1,590	7,742	1,590	1,590	1,590	1,590	6,360
Interest expense on convertible notes	3,474	3,473	3,476	3,476	13,899	3,290	3,290	3,290	3,290	13,160	3,290	3,290	3,290	3,290	13,160
Interest expense due to reinsurer	0	0	0	0	0	0	0	0	0	0	0	0	0	0	
Amortization of def policy acq costs and value of insurance in force acquired	25,656	28,405	27,776	27,712	109,549	29,587	31,970	34,520	36,533	132,610	37,205	38,984	40,468	41,936	158,594
Other operating costs and expenses	11,411	14,083	11,582	11,154	48,230	12,451	12,200	12,500	15,100	52,251	15,300	15,600	15,900	13,800	60,600
<b>Total benefits and expenses</b>	<b>158,266</b>	<b>165,496</b>	<b>174,591</b>	<b>181,302</b>	<b>679,655</b>	<b>183,711</b>	<b>186,763</b>	<b>191,381</b>	<b>198,169</b>	<b>760,024</b>	<b>202,537</b>	<b>209,211</b>	<b>215,434</b>	<b>218,768</b>	<b>845,950</b>
Income before income taxes, minority interests and cumulative effect of change in acct principle	23,143	24,866	25,061	25,642	98,712	27,191	28,679	30,723	29,984	116,577	29,729	30,661	31,173	34,008	125,571
Income tax expense	8,010	8,539	8,639	8,622	33,810	9,457	9,980	10,692	10,434	40,563	10,344	10,669	10,847	11,833	43,693
Tax %	34.6%	34.3%	34.5%	33.6%	34.3%	34.8%	34.8%	34.8%	34.8%	34.8%	34.8%	34.8%	34.8%	34.8%	34.8%
Income before minority interests and cumulative effect of change in acct principle	15,133	16,327	16,422	17,020	64,902	17,734	18,699	20,031	19,550	76,014	19,385	19,992	20,327	22,175	81,878
Operating Earnings	15,133	16,327	16,422	17,020	64,902	17,734	18,699	20,031	19,550	76,014	19,385	19,992	20,327	22,175	81,878
Operating Earnings Per Share	\$ 0.26	\$ 0.28	\$ 0.28	\$ 0.29	\$ 1.10	\$ 0.31	\$ 0.33	\$ 0.35	\$ 0.35	\$ 1.34	\$ 0.34	\$ 0.35	\$ 0.36	\$ 0.39	\$ 1.44
Weighted Average Fully-Diluted Shares Outstanding	60,159	60,309	59,774	59,154	59,849	58,221	57,332	57,332	57,332	57,554	57,532	57,732	57,732	57,732	57,682

**American Equity Investment Earnings Model Cont.**

	Q1 07	Q2 07	Q3 07	Q4 07	2007	Q1 08	Q2 08E	Q3 08E	Q4 08E	2008E	Q1 09E	Q2 09E	Q3 09E	Q4 09E	2009E
<b>Balance Sheet Data</b>															
Invested Assets	\$ 11,493,483	\$ 12,112,858	\$ 12,444,115	\$ 12,610,895	\$ 12,610,895	\$ 12,807,232	\$ 13,223,855	\$ 13,552,130	\$ 13,878,971	\$ 13,878,971	\$ 14,223,010	\$ 14,648,111	\$ 14,977,405	\$ 15,304,463	\$ 15,304,463
Total Assets	15,098,204	15,800,678	16,174,792	16,394,372	16,394,372	16,557,973	16,974,596	17,302,871	17,629,712	17,629,712	17,973,751	18,398,852	18,728,146	19,055,204	19,055,204
Policy Reserves	13,491,268	14,001,669	14,394,309	14,711,780	14,711,780	14,753,115	15,210,506	15,562,530	15,910,643	15,910,643	16,278,648	16,744,947	17,097,186	17,444,461	17,444,461
Shareholder's Equity	606,573	601,703	619,031	611,635	611,635	624,902	643,601	662,632	683,182	683,182	702,566	722,559	742,885	765,060	765,060
Shareholder's Equity (ex. FASB 115)	645,422	667,985	668,396	650,564	650,564	684,013	702,712	722,743	742,293	742,293	761,677	781,670	801,996	824,171	824,171
Book Value Per Share	\$ 10.80	\$ 10.58	\$ 11.01	\$ 10.94	\$ 10.94	\$ 11.56	\$ 11.91	\$ 12.28	\$ 12.64	\$ 12.64	\$ 13.00	\$ 13.37	\$ 13.75	\$ 14.16	\$ 14.16
Book Value Per Share (ex. FASB 115)	\$ 11.49	\$ 11.75	\$ 11.89	\$ 11.63	\$ 11.63	\$ 12.66	\$ 13.00	\$ 13.37	\$ 13.74	\$ 13.74	\$ 14.09	\$ 14.46	\$ 14.84	\$ 15.25	\$ 15.25
Shares Outstanding	56,182	56,855	56,205	55,919	55,919	54,043	54,043	54,043	54,043	54,043	54,043	54,043	54,043	54,043	54,043
<b>Other Data</b>															
Gross Sales	\$ 444,479	\$ 622,510	\$ 543,791	\$ 533,902	\$ 2,144,682	\$ 515,160	\$ 608,791	\$ 533,791	\$ 533,791	\$ 2,191,533	\$ 555,670	\$ 656,791	\$ 575,791	\$ 575,791	\$ 2,364,043
Net Sales	443,888	622,026	543,405	533,584	2,142,903	514,623	608,791	533,791	533,791	2,190,996	555,670	656,791	575,791	575,791	2,364,043
Net Annuity Reserves	11,365,106	11,900,907	12,359,599	12,740,219	12,740,219	13,048,910	13,506,301	13,858,325	14,206,438	14,206,438	14,574,443	15,040,742	15,392,981	15,740,256	15,740,256
<b>Margin Analysis</b>															
Benefit Ratio	59.4%	58.1%	60.6%	62.3%	60.2%	61.6%	61.5%	60.5%	59.8%	60.8%	60.3%	60.3%	60.5%	60.6%	60.4%
Expense Ratio	307.6%	290.2%	247.2%	245.4%	269.9%	272.7%	266.8%	264.1%	284.8%	272.2%	301.6%	303.1%	292.6%	284.3%	295.1%
Policy Benefit Ratio	63.2%	65.7%	70.6%	66.9%	66.7%	78.7%	78.7%	78.7%	78.7%	66.7%	78.7%	78.7%	78.7%	78.7%	78.7%
Pretax Margin	12.8%	13.1%	12.6%	12.4%	12.7%	12.9%	13.3%	13.8%	13.1%	13.3%	12.8%	12.8%	12.6%	13.5%	12.9%
Tax Rate	34.6%	34.3%	34.5%	33.6%	34.3%	34.8%	34.8%	34.8%	34.8%	34.8%	34.8%	34.8%	34.8%	34.8%	34.8%
Net Margin	8.3%	8.6%	8.2%	8.2%	8.3%	8.4%	8.7%	9.0%	8.6%	8.7%	8.3%	8.3%	8.2%	8.8%	8.4%
Return on Equity (ex. FAS 115)	9.5%	9.9%	9.8%	10.3%	9.9%	10.6%	10.8%	11.2%	10.7%	10.9%	10.3%	10.4%	10.3%	10.9%	10.5%

Source: Company reports and Raymond James estimates.  
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- Strong Buy (SB1)** ..... Expected to appreciate and produce a total return of at least 15% and outperform the S&P 500 over the next six months. For higher yielding and more conservative equities, such as REITs and certain MLPs, a total return of at least 15% is expected to be realized over the next 12 months.
- Outperform (MO2)** ..... Expected to appreciate and outperform the S&P 500 over the next 12 months. For higher yielding and more conservative equities, such as REITs and certain MLPs, an Outperform rating is used for securities where we are comfortable with the relative safety of the dividend and expect a total return modestly exceeding the dividend yield over the next 12 months.
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### Suitability Categories (SR)

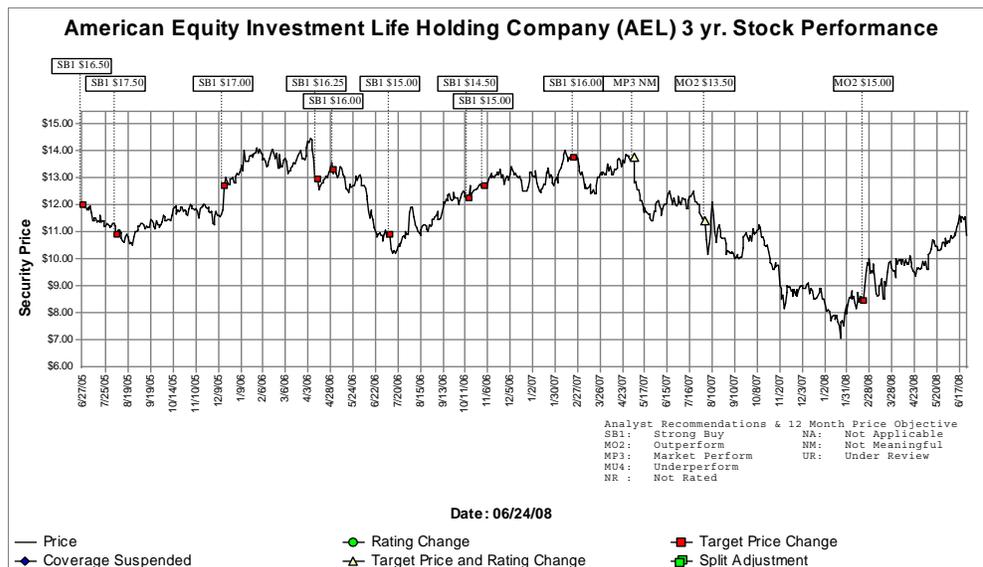
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- Aggressive Growth (AG)** ..... Medium or higher risk equities of companies in fast growing and competitive industries, with less predictable earnings and acceptable, but possibly more leveraged balance sheets.
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Company Name	Disclosure
American Equity Investment Life Holding Company	Raymond James & Associates lead-managed a follow-on offering of AEL shares in December 2005. Raymond James & Associates or one of its affiliates owns more than 1% of the outstanding shares of American Equity Investment Life Holding Company.

**Target Prices:** The information below indicates our target price and rating changes for AEL stock over the past three years.



Update Date	Closing Price	Target Price	Rating
2/21/08	8.44	15.00	2
8/2/07	11.41	13.50	2
5/3/07	13.75	NM	3
2/22/07	13.76	16.00	1
11/1/06	12.70	15.00	1
10/13/06	12.25	14.50	1
7/11/06	10.89	15.00	1
5/3/06	13.31	16.00	1
4/12/06	12.94	16.25	1
12/16/05	12.70	17.00	1
8/5/05	10.90	17.50	1
6/27/05	11.99	16.50	1

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