

## **FITCH AFFIRMS NAVY MUTUAL AID ASSOCIATIONS' IFS RATING AT 'A+'**

Fitch Ratings-Chicago-02 October 2012: Fitch Ratings has affirmed Navy Mutual Aid Association's (NMAA) Insurer Financial Strength (IFS) rating at 'A+'. The Rating Outlook is Stable.

NMAA's IFS rating and Stable Outlook reflect the association's strong capital levels, high-quality and liquid investment portfolio, conservative financial profile, and moderate top-line growth. Product liabilities are predominantly composed of term and universal life insurance products which have predictable cash flows and are free of more volatile variable annuity products.

Fitch views as additional strengths NMAA's conservative reserving, excellent persistency, and consistently low expense ratios. Fitch believes that NMAA's mortality experience is within expectations.

NMAA's balance sheet strength is highlighted by a year-end 2011 investment portfolio composed of 31% U.S. government-guaranteed or government-sponsored enterprise debt. Exposure to structured securities is very low at less than 2% of investments and consists primarily of agency-backed residential mortgage backed securities.

Portfolio yields have consistently exceeded 6%, which is well above industry averages and has allowed the company to credit high excess interest on its life insurance policy reserves. Recent yields on new money investments are below portfolio levels, as they are across the life insurance industry, and the prospect of a prolonged low interest rate environment has led the company to mitigate this risk by adjusting crediting rates on its products. NMAA also maintains a higher than normal level of cash to counteract the possibility of rapidly rising interest rates that might lead to higher than normal product lapses, and simultaneously allow NMAA to increase portfolio yields.

Rating concerns include the long-term challenge of membership growth and NMAA's limited access to capital markets, although Fitch considers financial flexibility adequate in respect to NMAA's unique business profile and product portfolio.

NMAA's total adjusted capital (TAC) grew 2% in 2011 to \$221 million and NAIC risk-based capital (RBC) increased to 399% from 379%, driven primarily by net operating income and a reserve decrease related to changes made to reserving methods. Fitch believes the reserving changes have led to more accurate product reserves.

Net operating income declined to \$3.8 million in 2011 from \$7 million in 2010 and \$20 million in 2009 as NMAA posted increased death benefit payments. Fitch expects net operating income and TAC to increase to a greater degree in 2012, absent any mortality spikes.

NMAA has a strong niche position as a low-cost provider of insurance protection products to the United States sea services and their families. NMAA serves active, reserve and retired members of the U.S. Navy, U.S. Marine Corps, U.S. Coast Guard, U.S. Public Health Service and National Oceanic and Atmospheric Administration and had total assets of approximately \$2.7 billion at year-end 2011. The association is located in Arlington, VA and had approximately 112,600 members and \$23 billion of insurance in force at the end of 2011.

NMAA's ratings are based in part on its unique profile as a modest-scale, nonprofit institution serving a narrow customer base. Fitch believes that the Association's strategy to provide high-value products to its customers and maintain prudent levels of reserves and capital, rather than generating stronger earnings and higher reserving and capital levels, limits the upside range of its IFS rating. Barring any change in these qualities, Fitch views Navy Mutual at the upper end of that range.

Key ratings drivers that could result in a downgrade include:

- A decline in estimated risk based capital to below 300% company action level;
- A significant change in war risk exposure and experience;
- An unfavorable change in tax/regulatory status.

Fitch affirms the following rating with a Stable Outlook:

Navy Mutual Aid Association

--IFS at 'A+'.

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Applicable Criteria and Related Research:

--Insurance Rating Methodology' (September 22, 2011).

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Insurance Rating Methodology

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