

FITCH AFFIRMS NAVY MUTUAL AID ASSOCIATION'S IFS RATING AT 'A+'

Fitch Ratings-Chicago-05 August 2013: Fitch Ratings has affirmed Navy Mutual Aid Association's (NMAA) Insurer Financial Strength (IFS) rating at 'A+'. The Rating Outlook is Stable.

KEY RATING DRIVERS

NMAA's IFS rating and Stable Outlook reflect the association's strong capital levels, high-quality and liquid investment portfolio, and conservative financial profile. 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 2012 investment portfolio composed of 36% 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.

The company's portfolio yields were up a small amount in 2012, after following the general industry trend of declining yields the previous two years. The increase reflects small changes to the risk profile of NMAA's investment portfolio and the reinvestment of a portion of NMAA's higher than normal level of cash into more productive assets. NMAA's yields have consistently exceeded 6%, which is well above industry averages. NMAA's strong investment performance has allowed the company to credit high excess interest on its life insurance policy reserves.

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

NMAA's total adjusted capital (TAC) was flat in 2012 at \$220 million and year-end 2012 NAIC risk-based capital (RBC) was 394% compared to 399% at year-end 2011, driven primarily by higher net operating income that was offset by a \$22 million reserve increase related to changes made to reserving methods. The 2012 reserve increase is mainly a continuing evaluation of product reserves that led to a similar increase in 2011 term life reserves. Fitch believes the reserving changes have led to more appropriate product reserves.

Net operating income increased to \$22.9 million in 2012 from \$3.8 million in 2011 as NMAA posted decreased death benefit payments. For 2013 Fitch expects the net operating income level to be similar and TAC to increase, 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 2012. The association is located in Arlington, VA and had approximately 113,800 members and \$23 billion of insurance in force at the end of 2012.

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 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.

RATING SENSITIVITIES

Key ratings drivers that could result in a downgrade include:

- A decline in estimated RBC 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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Additional information is available at 'www.fitchratings.com'.

Applicable Criteria and Related Research:

--'Insurance Rating Methodology' (January 11, 2013).

Applicable Criteria and Related Research:

Insurance Rating Methodology — Amended

http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=698731

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