FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms Navy Mutual's Ratings; Outlook Stable on Coronavirus Review

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Fitch Ratings - Chicago - 01 May 2020: Fitch Ratings has affirmed the 'A+' Insurer Financial Strength (IFS) ratings of Navy Mutual Aid Association (Navy Mutual). The Rating Outlook is Stable.

KEY RATING DRIVERS

Fitch's current assessment of the impact of the coronavirus pandemic, including its economic impact, is based on a set of ratings assumptions described below. These assumptions were used by Fitch to develop pro forma financial metrics for Navy Mutual that Fitch compared to both ratings guidelines defined in its criteria, and relative to previously established Rating Sensitivities for Navy Mutual.

The Stable Outlook reflects Fitch's view that the company will experience only a limited degree of capital- and earnings-related pressures over the nearer term as a result of the sharp equity market decline and increased investment losses driven by the economic downturn. These assumptions create modest pressure on Navy Mutual's pro forma financial metrics, which is offset by the company's very strong capital position and very conservative investment portfolio.

Based on the application of Fitch's Coronavirus Rating Case Assumptions, Navy Mutual's capital as measured by Fitch's Prism capital model would decline modestly but remain in the 'Extremely Strong' category. Further, Fitch notes that Navy Mutual maintains a strong liquidity profile and does not carry any financial leverage.

Longer-term concerns include exposure to persistently low interest rates, which could pressure results if current rates are maintained. However, Fitch notes that Navy Mutual effectively manages this risk through product design, pricing, and active duration and liquidity management.

The ratings assigned to Navy Mutual continue to reflect the association's very strong capitalization, adequate profitability and conservative investment profile. The rating also considers the company's small, niche market position and scale along with its interest-sensitive product profile.

Navy Mutual has a solid niche position as a low-cost provider of insurance protection products to United States uniformed service members and their families. However, Navy Mutual's relatively modest size and scale could heighten the impact of unexpected adverse scenarios. Offsetting the company's modest operating scale is management's conservative operating strategy and lower than industry product risk.

While some level of losses or impairments may occur, Fitch views Navy Mutual's investment profile as very strong, and to be one of the most conservative portfolios in Fitch's rated universe. Below-investment-grade bonds make up only 2% of total invested assets, and the company has below-average exposure to 'BBB'-rated bonds, which limits the company's rating migration risk in the current economic environment. Furthermore, Navy

Mutual has very limited exposure to the structured classes that have experienced periods of volatility and driven unrealized losses for the industry over the last several weeks.

Navy Mutual's profitability is viewed as adequate and in line with mutual peers but relatively modest compared to the life industry, given its strategy of distributing excess earnings through relatively high crediting rates and policyholder dividends. Over the near term, Fitch expects that earnings may be modestly impacted by increased mortality. However, any adverse mortality experience is expected to be concentrated among older policyholders who typically hold policies with lower face amounts and a larger reserve cushion which will mitigate any impact.

Assumptions for Coronavirus Impact (Ratings Case):

Fitch used the following key assumptions, which are designed to identify areas of vulnerability, in support of the pro-forma ratings analysis cited above:

--Decline in key stock market indices by 35% relative to Jan. 1, 2020;

--Increase in two-year cumulative high yield bond default rate to 16%, applied to current non-investment grade assets, as well as, 12% of 'BBB' assets;

--Capital market access is limited for issuer at senior debt levels of 'BBB' and below;

--Both upward and downward pressure on interest rates, with spreads widening (including high yield by 400bps) coupled with notable declines in government rates.

RATING SENSITIVITIES

The ratings remain sensitive to any material change in Fitch's Rating Case assumptions with respect to the coronavirus pandemic. Periodic updates to our assumptions are possible given the rapid pace of changes in government actions in response to the pandemic, and the pace with which new information is available on the medical aspects of the outbreak. A discussion of how ratings would be expected to be impacted under a set of Stress Case assumptions is included at the end of this section to help frame sensitivities to a severe downside scenario.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--A material adverse change in Fitch's Ratings Assumptions with respect to the coronavirus impact;

--A decline in estimated risk-based capital (RBC) to below 400% company action level or a Prism capital model score below 'Extremely Strong';

--A trend of sustained net operating losses;

--A significant change in war risk exposure and experience;

--An unfavorable change in tax/regulatory status.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--A material positive change in Fitch's Rating Assumptions with respect to the coronavirus impact;

--A positive rating action is prefaced by Fitch's ability to reliably forecast the impact of the coronavirus pandemic on the financial profile of both the U.S. life insurance industry and Navy Mutual;

--Fitch does not anticipate an upgrade in the intermediate term, as Navy Mutual's small scale and narrow market focus limit the upside in its rating.

Stress Case Sensitivity Analysis

--Fitch's more severe Stress Case assumes a 60% stock market decline, two-year cumulative high yield bond default rate of 22%, more prolonged declines in government rates, heightened pressure on capital markets access, and a coronavirus infection rate of 15% and mortality rate of 0.75%;

--The implied rating impact under the Stress Case would be a downgrade of no more than one notch.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Financial Institutions issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

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The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
Navy Mutual Aid Association	Ins Fin Str	A+	Affirmed

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Douglas Baker
Associate Director
Primary Rating Analyst
+1 312 368 3207
Fitch Ratings, Inc. One North Wacker Drive Chicago 60606

Julie Burke, CFA, CPA
Managing Director
Secondary Rating Analyst
+1 312 368 3158

Keith Buckley, CFA
Managing Director
Committee Chairperson
+1 312 368 3211

MEDIA CONTACTS

Hannah James
New York
+1 646 582 4947
hannah.james@thefitchgroup.com

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Insurance Rating Criteria (pub. 02 Mar 2020) (including rating assumption sensitivity)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Prism U.S. Life Insurance Capital Model, v1.2.0-2018 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

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Navy Mutual Aid Association	EU Endorsed

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