Life Insurers
U.S. and Canada
Credit Analysis

Navy Mutual Aid Association

Ratings

Security Class	Rating
Insurer Financial Strength	A+

Outlook

Stable

Financial Data

Navy Mutual Aid Association

	12/31/07	$ Mil.
Increase in Net Assets from Operations	12/31/07	20.7
Net Assets	12/31/07	179
Debt and Hybrids	12/31/07	0
Prism Score	12/31/06	AAA

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Related Research

- *Fitch Affirms 'A+' Rating for Navy Mutual Aid Association, July 30, 2008*
- *Subprime Mortgage Exposure for U.S. Life Insurers — Update and Outlook, Feb. 21, 2008*
- *Review and Outlook 2007–2008: North American Life Insurance, Dec. 3, 2007*

Rating Rationale

- Navy Mutual Aid Association's (NMAA or the Association) 'A+' insurer financial strength rating reflects its strong capital, favorable business profile and strong niche position as a low cost provider of insurance protection products to active, reserve and retired members of the U.S. Navy, U.S. Marine Corps, U.S. Coast Guard, U.S. Public Health Service (USPHS), National Oceanic and Atmospheric Administration (NOAA) and their families. Honorably discharged veterans of the Sea Services in some states are also eligible to purchase NMAA plans.
- Fitch Ratings views as additional strengths NMAA's conservative reserving, excellent persistency, low mortality, consistently low expense ratios and a high-quality, liquid bond portfolio.
- Fitch believes that NMAA's "war risk" is being prudently managed and mortality experience is within expectations despite the current conflict in the Middle East.
- Rating concerns include NMAA's sluggish growth in membership in recent years, moderate surplus volatility and limited financial flexibility with no immediate access to capital markets. Fitch notes that premiums declined modestly in 2007 and that membership growth has been relatively flat over the past three years. However, NMAA's plan sales and insurance in force have increased due to the popularity of NMAA's family of plans, competitively priced products and value-added service to its membership.
- Fitch notes that NMAA continues to diversify its investment portfolio as a strategy to mitigate exposure to common stock price volatility. NMAA's reserve profile and member focus are key factors in NMAA's investment strategy, which includes a moderately higher-than-industry-average allocation to common stocks and a longer-than-average bond portfolio duration. This strategy has helped maintain the Association's strong dividend rates in recent years but also moderately increased surplus volatility and interest rate risk.

Key Rating Drivers

- Fitch expects NMAA will maintain strong capital levels as measured by Prism. A significant decline in capital to below 'A+' levels would lead to pressure on the ratings. Fitch expects NMAA to maintain a high-quality, liquid balance sheet in 2008. A significant increase in below-investment-grade bonds, credit-related impairments or common stock investment above policy limits would pressure ratings.
- Fitch expects NMAA to report solid operating performance in 2008, driven by low expenses, strong levels of investment income and very low credit-related investment losses.
- Fitch believes NMAA will exhibit renewed premium growth in 2008, driven by a successful marketing outreach to its membership base, moderate geographic expansion and comparative product value.

Key Rating Issues

Favorable Business Profile with a Defensible Niche

NMAA exhibits a stable business profile due to its unique customer base and favorable business mix. Fitch considers NMAA to have a secure position in its niche as a nonprofit provider of insurance protection and services for its membership, based upon its quality service, efficient operations and exceptionally competitive insurance products. Over 97% of product reserves are for individual life insurance products. The Association's very competitive crediting rates and low term premiums provide members value and build member loyalty.

Fitch views NMAA as serving a unique niche in terms of customer base and customer services. NMAA enjoys a strong reputation for integrity and service to its customer base. It has maintained a close relationship with the Sea Services and has avoided the market conduct issues that have plagued several other associations and commercial insurance companies that target the military market.

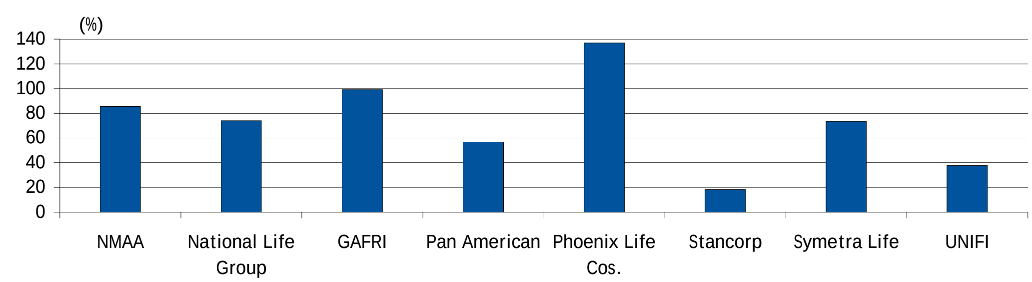
Sustainable Competitive Advantages Provide Stable Profitability

NMAA exhibits a substantial cost advantage versus many life insurers, as evidenced by its very low expense ratio (expense to assets) of 0.4%. A number of factors contribute to this low cost structure, including its low overhead, its lack of commissioned agents, its classification as a 501(c)(23) organization exempting it from federal income tax, and its regulatory exemption by the Virginia, North Carolina and South Carolina legislatures, recognizing its mission to provide coverage to Sea Service members and their families. In addition to low expenses, NMAA also benefits from a low mortality rate, reflecting the generally healthier population segment that NMAA is targeting and a stringent medical underwriting process.

Unique Mortality Risk Due to 'War Catastrophe' Is Manageable Despite Higher Policy Limits and Extended Iraq Conflict

Fitch believes that NMAA's "war risk" is being prudently managed and mortality experience is within expectations despite the current escalated levels of conflict worldwide in recent years. Since its inception, NMAA has been exposed to the possibility of catastrophic losses that could result from war. NMAA estimates that less than 20% of its current in-force book of business is currently eligible for war risk. Fitch believes that NMAA's current war reserves and mortality margins could experience a significant increase in adverse results for a sustained number of years without requiring additions. NMAA's held $73 million in "war risk and other adverse deviation" reserves,

Risky Assets to Total Adjusted Capital
(Year-End 2007)



Source: Highline Data, Fitch.

designed to protect against long-term excess claims due to war and other risks. Less than 2% of 2007 death benefits were war-related deaths.

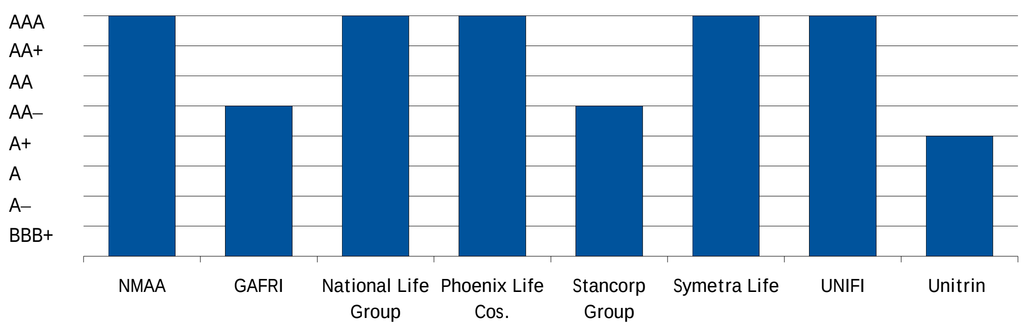
Investment Performance Continues to Be Very Strong

NMAA's high-quality fixed income portfolio continues to generate favorable investment yields of approximately 6.56% due in part to its long duration and low reinvestment risk. Credit-related capital losses were minimal in 2007, and NMAA has no subprime or Alt-A residential mortgages in its investment portfolio. Risky assets as a percentage of total adjusted capital have declined to below the aggregate life insurance industry average at year-end 2007.

Peer Analysis

NMAA compares favorably with other 'A+' rated life insurance companies in terms of capital strength as measured by Prism and growth in total adjusted capital over the last five years. Profitability measures, such as return on surplus, are average, but this is expected considering NMAA's high excess policyholder dividends. Risky assets as a percentage of total adjusted capital were close to industry aggregate levels at year-end 2007.

Prism Score — 'A' Rated Companies



Source: Fitch.

NMAA's main competitors include selected benefit societies and commercial insurance companies that typically target members of the military. As a result of NMAA's low cost structure and excellent mortality experience, NMAA's insurance policy rates and benefits compare very favorably with each of these competitors, as well as Servicemembers Group Life Insurance (SGLI). NMAA's survivor benefits services are also viewed as a distinctive product element among competitors.

Company Profile

NMAA is a mutual aid association, with eligible membership that currently includes all uniformed personnel of the Navy, Marine Corps, Coast Guard, NOAA and USPHS, including all enlisted and officer grades, regular, reserve and retired, as well as Sea Service veterans in some states. NMAA has headquarters in Arlington, Va., and a branch office to service members at the Norfolk naval base in Norfolk, Va.

Ownership Structure

NMAA is a member association created in 1879 to provide life insurance for the families of naval officers, as private insurance was rarely available to them at that time.

Membership expanded to the active reserves in 1920, Coast Guard in 1925, women officers in 1947, USPHS and NOAA in 1963, enlisted personnel in 1980 and retirees/inactive reserves in 1993. In addition, members could purchase life insurance for spouses beginning in 1985, and for their children and grandchildren beginning in 1996.

While NMAA currently has approximately 100,000 members, about 40% of all members are on active duty in the various services represented in NMAA. Fitch believes that the expected future decline in naval manpower could make it more challenging for NMAA to expand its membership base and grow premiums. NMAA's pool of eligible insureds was expanded in 1996 to include the children and grandchildren of members. Members can insure their children and grandchildren with an interest-sensitive whole life policy from NMAA, which is positioned as a way to help pay for the costs of a college education.

Products

NMAA serves its defined market with an uncomplicated selection of insurance and annuity product offerings. It also provides related informational services including survivor assistance, financial planning, financial services, entitlement education and federal benefits education.

NMAA currently offers two basic life insurance products: interest-sensitive whole life insurance and term life insurance. Additionally, the Association offers a number of death benefit settlement options for beneficiaries, as well as offering an accelerated death benefit option and a long-term care option. With the accelerated death benefit option, the policyholder can convert the death benefit of the policy to an accelerated payout option. The Association structures the payout so that it is revenue-neutral, illustrating that NMAA's focus is service to its members whatever their needs.

NMAA is increasing its membership base and revenue through the introduction of a number of member-requested products, such as rated plans on its Permanent "Plus" products, new versions of its Level II "Plus" Term product and increased maximum coverage limits for members and spouses.

In recent years, NMAA diversified its product portfolio with the offering of a single-premium deferred annuity (SPDA), a flexible-premium deferred annuity (FPDA) and a single-premium immediate annuity (SPIA). These individual annuity products include an SPDA with various interest rate lock-in periods, a market-value adjustment and no surrender charge for early, full withdrawals. Also offered is a simplified SPIA. While these products have attractive crediting rates versus competitors' annuity offerings, sales have been slower than expected due in part to the favorable crediting rates on NMAA's interest-sensitive whole life products.

The long-term care option is offered to all members or spouses who have been insured with an interest-sensitive policy for at least two years, are at least 60 years old, have been in a long-term care situation for at least four months and are likely to be in that situation permanently. The

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Product Profile — 2007
($ Mil.)

	Products	
	Individual Life	Individual Annuity
Markets		
Individual	X	X
Financial Data ($ Mil.)		
General Account Reserves	1,776	159
Separate Account Reserves	0	0
Premiums and Deposits	42	9
% of Total	82	18
Distribution		
Direct	X	X

Source: Fitch, Highline Data.

death benefit, less any loans, can be converted to an annuity payout for a specified period. This feature also benefits NMAA, as members are provided with a disincentive to cash out their policies. There is no additional fee for inclusion of this provision, nor is there any charge for its exercise.

Distribution Channels

New plans are generated through two main sources: direct marketing and member referrals.

New members are obtained via member referrals, print media ads, direct mail, Web-based advertising and via NMAA's Web site. Approximately one-third of new members result from direct mail and one-fourth join because of NMAA member referrals.

NMAA's sales are conducted only by salaried employees out of its home office. As a part of its mission to provide education to its membership concerning government survivor and retirement benefits, NMAA makes approximately 700 presentations to an estimated 28,000 service members annually. Educators are not permitted to sell NMAA products. If, after a presentation, a service member is interested in buying a policy from NMAA, that person must contact the home office for an application. This approach has made the organization nearly immune from charges of improper sales practices.

Fitch views growth in the number of new members as one of NMAA's intermediate-term challenges. Membership has hovered around the 100,000 level for the last five years as NMAA's Career Assistance Program (CAP) declined as an important generator of new members. Fitch believes that NMAA's strategic plan to increase the communication of its needs-based value proposition and continued excellent service and education, which began in 2006, will have a beneficial effect on new membership levels.

Financial Analysis

Profitability

Fitch views NMAA's operating performance over the past three years as good, characterized by consistent, moderate pre-dividend gains from operations and moderate premium growth.

Fitch views NMAA's operating performance over the past three years as good, characterized by consistent, moderate pre-dividend gains from operations and moderate premium growth. Key drivers were low expense levels, good investment income and favorable persistency and mortality.

As a mutual entity, the Association does not generate a significant statutory net operating gain. NMAA allocates revenue in excess of that required by its financial plan for required reserve and surplus increases to increase the cash values of its interest-sensitive whole life policies and to provide premium refunds on its term policies. While the excess revenue flows through the Association's income statement as an operating loss, NMAA could redirect this excess revenue to its surplus base. Crediting rate decisions are normally made once a year, but NMAA has the flexibility to respond to changing interest rates or the need to retain surplus. The Association has demonstrated this flexibility by modifying its crediting rates to reflect changes in interest rate levels and investment portfolio performance.

Expenses are well managed and very low as exhibited by an expense ratio of 0.4% (expenses to total assets), due to very low acquisition costs (no commissioned sales force, moderate advertising), no taxes and focused target markets. Mortality experience continues to be favorable with modest war-related claims in 2007. Investment income has been strong, favorably affected by a bond portfolio with low reinvestment risk. The portfolio's low allocation to mortgage-backed securities and the presence of zero coupon bonds have kept portfolio yields from being significantly affected by reinvestment risk.

Operating Performance

($ Mil.)

	2007	2006	2005	2004	2003
Total Premium Income	51	52	60	59	41
Investment Income	135	129	123	116	110
Total Revenue	186	181	184	175	152
Gain Before Federal Income Tax and Dividend	44	44	38	33	27
Policyholder Dividend	32	31	29	25	24
Pretax Gain from Operations	12	13	9	8	3
Federal Income Tax	0	0	0	0	0
Net Operating Gain	12	13	9	8	3
Realized Capital Gains	8	1	18	0	3
Net Income	21	14	27	8	6
Total Net Admitted Assets	2,172	2,074	1,957	1,844	1,716
Operating Return on Total Adjusted Capital (%)	6.2	7.4	5.9	5.7	5.2
Pretax Return on Total Assets Pre-Dividend (%)	2.1	2.1	2.0	1.8	1.6
Pretax Return on Total Assets Post-Dividend (%)	0.6	0.6	0.5	0.4	0.2
Pretax Operating Margin (%)	6.6	7.2	4.8	4.3	2.1
Expense Ratio (%)	0.4	0.4	0.4	0.4	0.4
Net Investment Yield (%)	6.6	6.7	6.7	6.7	6.9

Note: Statutory accounting principles.
Source: Navy Mutual Aid Association.

Investments and Liquidity

Fitch considers NMAA's investment portfolio to be conservatively managed and the asset mix to be appropriate for its product liabilities and investment strategy. Fitch believes NMAA's invested assets have low exposure to credit risk and modest exposure to equity market volatility and changes in interest rate levels. Fitch notes that NMAA has taken additional steps to reduce the moderate surplus volatility caused by market value changes in its equity investments. The Association made marginal adjustments to its equity and real estate portfolio allocations.

The majority of invested assets are managed internally by NMAA.

Fitch views NMAA's investment performance as good with consistent levels of investment income and strong credit-related performance.

Fitch views the Association's investment performance as good with consistent levels of investment income and strong credit-related performance. The invested asset investment yield of 6.6% compared quite favorably with the life industry's average yield of 5.7%, due in part to its longer-than-average duration and low exposure to callable bonds and mortgage-related securities. Realized losses related to credit impairments have been minimal and have compared very favorably with the life insurance industry.

The Association's bond portfolio is composed of assets that are of very high credit quality. More than one-third of the bond portfolio was invested in U.S. Treasury and federal agency and government-sponsored enterprise securities at year-end 2007. The investment policy assures that only companies whose bonds are rated 'BBB' or better and with a Stable to Positive Rating Outlook are eligible for purchase, with a limit on investment in 'BBB' rated bonds of 15% of the bond portfolio. The ratio of below-investment-grade bonds to total adjusted capital at 21.4% is low when compared to the 2007 life and health insurance industry average of approximately 40%.

NMAA's bond portfolio typically exhibits a long duration to better match the life insurance–dominated liability portfolio. The long duration of assets exposes NMAA to interest rate risk and historically has been a key driver of excess interest crediting rate levels. Fitch considers this risk as reasonable since yields on these assets are normally well above the minimum yields required to fulfill the liability requirement, thus minimizing the reinvestment risk.

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Investment Portfolio

($ Mil.)

	2007	2006	2005	2004	2003
Total Invested Assets	2,135	2,039	1,924	1,811	1,686
% Bonds	85.6	84.6	84.6	84.2	83.7
% Common and Preferred Stock	6.2	7.4	6.8	6.8	6.4
% Mortgage Loans	0.2	0.2	0.3	0.3	0.5
% Real Estate	0.2	0.2	0.2	0.2	0.3
% Policy Loans	6.4	6.4	6.5	6.6	7.1
% Cash and Equivalents	0.5	0.4	0.4	0.4	0.3
% Affiliated Investments	0.0	0.0	0.0	0.0	0.0
% Other Invested Assets	0.9	0.8	1.2	1.4	1.7
Below Investment Grade/Total Adjusted Capital (%)	21.4	19.9	23.1	14.3	25.8
Troubled Real Estate/Total Adjusted Capital (%)	0.0	0.0	0.0	0.0	0.0
Unaffiliated Common Stock/Total Adjusted Capital (%)	64.0	78.9	82.6	86.1	90.0
Schedule BA Other Invested Assets/TAC (%)	8.8	8.5	15.1	17.2	24.3
Risky-Assets Ratio (%)	85.5	98.8	105.6	100.4	115.8

Note: Statutory accounting principles.
Source: Navy Mutual Aid Association, Fitch Ratings.

In addition NMAA limits its aggregate investment in common stocks, direct mortgages and private real estate trusts to 6% of total assets. Fitch believes that while NMAA's higher-than-industry-average allocation to common stocks is not an unreasonable long-term investment strategy considering the Association's liability profile and its smaller allocation to other higher-risk assets such as mortgages and real estate, it does add volatility to NMAA's surplus position. Directly placed mortgage loans accounted for only 0.2% of NMAA's investment portfolio, and all loans are in a performing status.

Fitch considers NMAA's asset liability management to be sound. NMAA's signature product is its interest-sensitive whole life insurance policy, and recent product additions include a modest line of annuity products. The Association conducts cash flow studies under a variety of interest rate scenarios and equity market scenarios to ensure that its cash flow matching is sufficient to mitigate any potential disintermediation. Under its most severe interest rate scenario, management determined that the composition and distribution of its investment portfolio were more than sufficient to meet its cash flow demands without any undue harm to its financial strength or adverse effect on the cash values of its existing members.

Fitch believes NMAA's liquidity is very good due to the composition of the invested assets and conservative product design features.

Fitch believes NMAA's liquidity is very good due to the composition of the invested assets and conservative product design features. The investment portfolio is composed of more than 92% cash and publicly traded securities. NMAA's product design features high crediting rates on the interest-sensitive whole life policies and various settlement options that pay above-market interest rates, providing added incentive for members to leave their money with NMAA. Additionally, good levels of cash flow from operations provide an added level of comfort regarding the protection provided to policyholders.

Incremental income is generated by NMAA's securities lending program with $102 million under loan at year-end 2007.

Capitalization

NMAA is strongly capitalized as measured by Prism, Fitch's economic capital model, as available capital was 128% of Prism's 'AAA' stress level at year-end 2006. Fitch expects to complete its analysis of NMAA's year-end 2007 Prism results this summer. Key factors favorably affecting NMAA's Prism score include the large book of participating individual life reserves, high-quality investment portfolio and large reserve for war risk and other adverse deviations.

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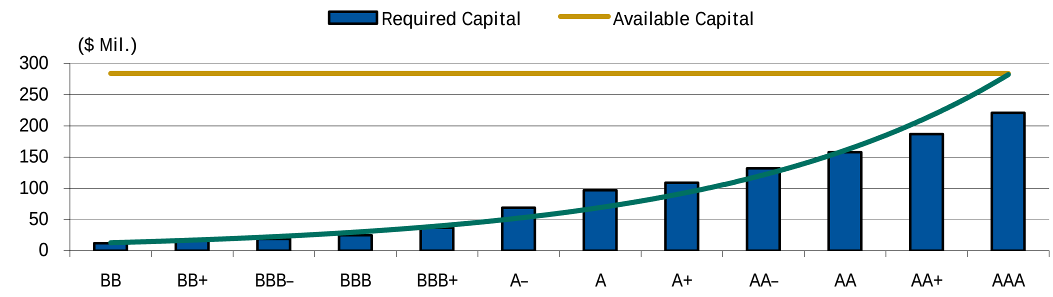
Prism Results — Available and Required Capital at Various Thresholds



Source: Fitch Ratings.

Fitch considers NMAA's $73 million voluntary reserve for war risk and other adverse deviations as additional support for the rating. This special reserve was established to protect against long-term excessive claims due to war and/or other risks and adverse investment yield scenarios.

However, changes in year-to-year reported adjusted surplus have experienced moderate volatility over the past five years due to the changes in market values of its common stock holdings. Fitch believes the 2007 investment allocation modifications will have a favorable effect upon this volatility.

Fitch views NMAA's estimated statutory risk-adjusted capital ratio as strong at approximately 350% of the company action level at year-end 2007. While NMAA carefully monitors and manages its risk-adjusted capital levels, as an association, it is not regulated as an insurance company.

For the five-year period ended Dec. 31, 2007, adjusted surplus has grown at a 14% compounded annual growth rate (CAGR), despite the high crediting rate paid out to participating policyholders. A significant portion of this high payout has been generated by realized and unrealized capital gains from its common stock portfolio. Fitch believes

Capitalization

($ Mil.)

	2007	2006	2005	2004	2003
Beginning-of-Period Total Adjusted Capital	192	158	144	121	83
Net Operating Gain	12	13	9	8	3
Net Realized Gain/Loss	8	1	18	0	3
Change in Unrealized Gain/Loss	(0)	20	(13)	15	24
Change in Reserve Valuation	0	0	0	0	0
Paid-in Capital/Surplus	0	0	0	0	0
Dividends to Stockholders	0	0	0	0	0
Other Changes	(4)	0	0	0	8
Total Changes	16	34	14	23	38
End-of-Period Total Adjusted Capital	208	192	158	144	121
Statutory Surplus	179	163	133	121	100
Asset Valuation Reserve	30	28	25	23	21
1/2 Policyholders' Dividends	0	0	0	0	0
Regulatory Capital (Total Adjusted Capital)	208	192	158	144	121
Assets/Statutory Surplus (x)	12.2	12.7	14.7	15.2	18.8
Adjusted Liabilities/Statutory Surplus (x)	11.0	11.5	13.5	14.0	17.5

Note: Statutory accounting principles.
Source: Navy Mutual Aid Association.

that management has the flexibility and discipline to adjust dividend rates if necessary to maintain strong levels of capital. The Association employs conservative reserving practices as well.

NMAA has historically used a catastrophic reinsurance policy from a highly rated insurance company to mitigate its exposure to any potential catastrophic losses occurring during a war. While current pricing of such coverage is not deemed attractive, NMAA continues to seek reasonable and cost-efficient levels of excess loss/catastrophe insurance coverage. Fitch believes that such coverage is a prudent hedging of mortality risk.