Navy Mutual Aid Association

Full Rating Report

Ratings

Security Class	Rating
Insurer Financial Strength	A+

Rating Outlook

Stable

Financial Data

($ Mil.)	12//31/10
Total Adjusted Capital	217
Surplus Notes Outstanding	0
Statutory Net Income	3
Operating Return on TAC (%)	3.8
Risk-Based Capital (%)	379

Note: Statutory data.
Source: NMAA, Fitch.

Related Research

Fitch Affirms Navy Mutual Aid Associations' IRS Rating at 'A+", Sept.15, 2011

Life Insurers' Mortgage Portfolios — Better Than Expected, June 21, 2011

2011 Outlook: U.S. Life Insurance, Jan. 11, 2011

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Key Rating Drivers

Strong Capital Levels: Navy Mutual Aid Association's (NMAA or the Association) 'A+' insurer financial strength (IFS) rating reflects its strong capital and conservative reserving. Financial flexibility is considered adequate in respect to Navy Mutual's unique business profile and product portfolio.

High-Quality Liquid Investment Portfolio: Navy Mutual's investment portfolio is composed of more than 37% U.S. government-guaranteed or government-sponsored enterprise debt and high-quality corporate bonds, with no exposure to problematic structured securities. Portfolio yields have consistently exceeded 6% and realized credit losses compare favorably with the life industry over the 2008–2010 period.

Modest Scale and Narrow Focus: NMAA occupies a modest scale position in the life insurance industry and serves a narrow market. Rating concerns include Navy Mutual's limited access to capital markets and the long-term challenge of membership growth due to its niche customer market.

Favorable Business Profile/Strong Niche Position: The Association is a low-cost provider of life insurance protection products to the U.S. sea service members and their families. Navy Mutual exhibits a conservative financial profile with predictable cash flows. Product liabilities are composed of predominately term and whole life insurance products with no variable annuity products.

War Risk Is Well-Managed: Fitch Ratings believes that the Association's "war risk" is prudently managed and that mortality experience is within expectations despite the current conflicts in the Middle East.

Macroeconomic Headwinds: Key concerns include the European sovereign debt crisis and potential contagion into other asset classes, low interest rates, financial market volatility, and weak economic recovery. Fitch expects these factors will constrain NMAA's earnings over the near term and could have a material negative impact on the company's earnings and capital in a severe, albeit unexpected, scenario.

What Could Trigger a Rating Action

Downgrade Triggers: A decline in risk-based capital (RBC) below 300% of the company action level, a spike in investment-related losses, or a trend of sustained net operating losses could have a negative impact on NMAA's ratings. Additionally, increased war risk exposure or a change in tax or regulatory status could trigger a downgrade.

Upgrade Triggers: Fitch views Navy Mutual at the upper end of its IFS range. Navy Mutual's ratings are based in part on its unique profile as a nonprofit institution serving a narrow customer base. Fitch believes that the Association's strategy that provides high-value products to its customers and maintains 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.

Company Profile

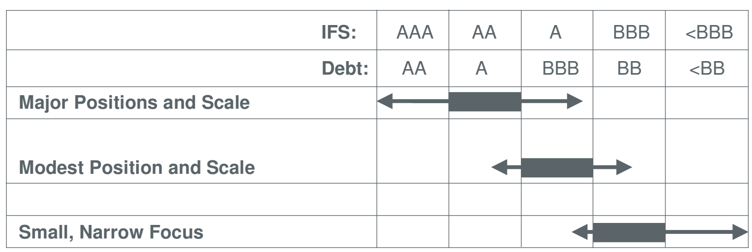
Unique Structure — Narrow Focus and Moderate Scale

Navy Mutual's ratings are based in part on its unique profile as a nonprofit institution serving a narrow customer base. Navy Mutual is a member association created in 1879 to provide life insurance for the families of naval officers as private insurance was rarely available at that time.

Fitch views Navy Mutual as serving a unique niche in terms of a customer base and customer services. Limited to a large degree by its focused customer market, the Association has modest scale and a narrow focus in comparison with many peers in the life insurance industry. Positively, Navy Mutual 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.

These favorable characteristics allow Fitch to rate MNAA above the range typical for insurers with a narrow focus and moderate scale.

Ratings Range Based on Market Position and Size/Scale



Favorable Business Profile with a Defensible Niche

Navy Mutual exhibits a stable business profile due to its unique customer base and favorable business mix. Fitch considers Navy Mutual to have a secure position in its niche as a nonprofit provider of insurance protection and services for its membership based on its quality service, efficient operations, and exceptionally competitive insurance products. More than 90% of product reserves are for individual life insurance products. The Association's very competitive crediting rates and low term premiums provide members with value and build member loyalty.

Navy Mutual exhibits a substantial cost advantage versus many life insurers, as evidenced by its very low expense ratio (expense to assets) of 0.5%. 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 express regulatory exemption in selected states, recognizing its mission to provide coverage to sea service members and their families. In addition to low expenses, Navy Mutual also benefits from a low mortality rate, reflecting the generally healthier population segment that the Association is targeting and a stringent medical underwriting process.

Related Criteria

Insurance Rating Methodology, Sept. 22, 2011

Corporate Governance and Management

Corporate governance and management are adequate and neutral to the rating. Of the board of directors' 19 members, the majority are independent and consist of retired U.S. Navy, Marine Corp, or Coast Guard officers. NMAA reports results under statutory accounting principles.

Johnson Lambert & Co, LLP is NMAA's auditor. The audit opinion for 2010 was unqualified. No related party transactions occurred in 2010 and none are currently planned.

Challenge to Grow Membership

Fitch views growth in the number of new members as one of Navy Mutual's long-term challenges as the future decline in naval manpower could make it more challenging for Navy Mutual to expand its membership base and grow premiums.

Membership has hovered around 100,000 for the last five years since the Association terminated its Career Assistance Program (CAP), formerly an important generator of new members. Fitch believes that Navy Mutual's increased communication of its needs-based value proposition and continued excellent service and education are having a beneficial effect on new membership levels

Value-Added Products/Low-Cost Distribution

Navy Mutual serves its defined market with an uncomplicated selection of insurance and annuity product offerings. In addition, it provides related informational services including survivor assistance, entitlement education, and federal benefits education.

Navy Mutual 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. In recent years, Navy Mutual 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).

NMAA's operating performance benefits from its noncommissioned sales channels. New plans are generated through two main sources: direct marketing and member referrals. Navy Mutual's sales are conducted only by salaried employees out of its home office.

Risk Management Is Adequate

Fitch notes nothing unusual with respect to Navy Mutual's risk management practices relative to industry norms. Navy Mutual has chosen to manage risk by taking a relatively conservative stance on product risk.

Organizational Structure

Ownership Is a Moderate Positive to the Rating

Relative to the return-focused view of equity holders, Navy Mutual's ownership structure compares most closely with that of a mutual insurance company, aligning the interests of managers with those of policyholders, thereby promoting a stronger focus on maintaining financial strength. The Association's tax-exempt status also provides an advantage over tax paying competitors.

Navy Mutual is a mutual aid association formed in 1889. Eligible membership currently includes all uniformed personnel of the Navy, Marine Corps, Coast Guard, National Oceanic and Atmospheric Administration (NOAA), and U.S. Public Health Service Commissioned Corps (USPHS), including all enlisted and officer grades, regular, reserve, and retired, as well as sea service veterans in some states. Navy Mutual is headquartered in Arlington, VA, and has a branch at the Naval Station Norfolk in Norfolk, VA.

Industry Profile and Operating Environment

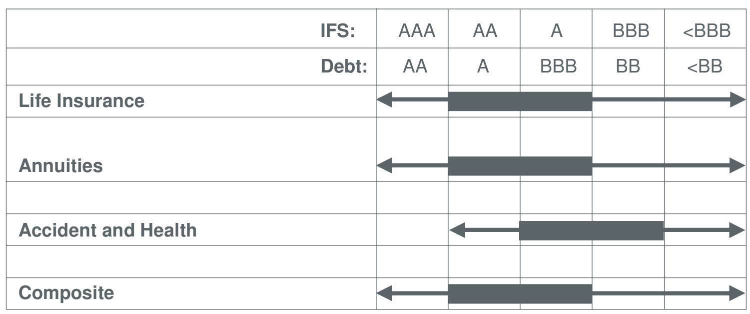
U.S. Life Industry Has Strong Balance Sheet Fundamentals

A majority of U.S. life insurers in Fitch's rated universe have IFS ratings in the 'AA' and 'A' categories. Key industry risk factors include: fixed-income and equity investment risks, macroeconomic uncertainty, low interest rates, and intense price competition, as well as regulatory and accounting uncertainty. The industry withstood the 2008–2009 financial crisis reasonably well, with capital largely rebounding due to earnings, investment gains, and capital raises. Balance sheets reflect very strong liquidity, reasonable financial leverage, and improved asset quality. Improved earnings continue to lag precrisis levels due to low interest rates and increased hedging costs. The industry's large in-force book of variable annuity business will continue to be a drag on profitability over the near term and could cause a material hit to industry earnings and capital in an unexpected, but still plausible, severe stress scenario.

Sovereign and Country Related Constraints

Fitch rates the sovereign obligations of the United States of America at 'AAA' with a Stable Outlook, and the Country Ceiling is similarly 'AAA'. Therefore, the ratings of U.S. insurance organizations and other corporate issuers are not constrained by sovereign or macroeconomic risks.

Ratings Range Based on Industry Profile/Operating Environment



Peer Analysis

NMAA Compares Well with 'A+' Peers

While moderate in scale and considered a niche writer, Navy Mutual has solid credit fundamentals and has outperformed many peer-rated companies in the challenging 2008–2009 period. Navy Mutual's risk-adjusted capital strength is comparable to that of other life insurance companies rated 'A+'. Profitability measures, such as return on surplus, are average as expected in considering the Association's high excess policyholder dividends. Fitch notes Navy Mutual's risky asset ratio is in line with selected peers.

Peer Comparison

(As of Dec. 31, 2010)

	Insurer Financial Strength	Risk-Based Capital (%)	TAC U.S. ($ Mil.)	Assets/ TAC (x)	General Account Liabilities/ TAC (x)	Risky Assets/ TAC (%)	Financial Leverage Ratio (%)	Pretax Return on Total Assets Post-Dividend (%)	Operating Return on TAC (%)
Navy Mutual	A+	379	217	13.4	12.3	71.5	0	0.32	3.8
Pan American Life	A	616	274	5.5	4..1	58.1	0	1.50	7.4
Liberty Life	A–	360	316	15.8	11.4	38.1	0	0.04	0.6
National Life	A+	393	1,263	13.7	13.1	91.3	21	1.00	10.7

TAC – Total adjusted capital. Note: Adjusted debt to TAC is for parent holding company.
Source: Fitch Ratings, Highline Data.

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

Capitalization and Leverage

	2006	2007	2008	2009	2010	Fitch's Expectation
Total Adjusted Capital ($ Mil.)	192	208	161	200	217	RBC will remain well above 300%. Navy Mutual will maintain a solid balance sheet in 2011 with strong capital levels.
Risk-Based Capital (%)[a]	332	331	334	360	379	
Adjusted Assets/TAC (x)	12.7	12.2	15.9	13.6	13.4	
Financial Leverage Ratio	—	—	—	—	—	

[a]Fitch estimate. TAC – Total adjusted capital.
Source: NMAA, Fitch.

Strong Capital, Policyholder Dividend Flexibility

- Solid risk-adjusted capital.
- War and adverse deviation reserve support capital.
- Capital flexibility due to whole life book.
- Low reliance on capital markets.

Fitch views Navy Mutual as strongly capitalized. Key factors favorably affecting the Association's capital profile include the large book of participating individual life reserves, high-quality investment portfolio, and large reserve for war risk and other adverse deviations. Financial flexibility is considered adequate in respect to Navy Mutual's unique business profile and product portfolio.

Solid Risk-Adjusted Capital

Fitch views Navy Mutual's estimated statutory risk-adjusted capital ratio as solid at approximately 379% of the company action level at year-end 2010. While Navy Mutual carefully monitors and manages its risk-adjusted capital levels, as a mutual aid association, it is not regulated as an insurance company.

War and Adverse Deviation Reserve Supports Capital

Fitch considers Navy Mutual's $76 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.

Capital Flexibility Due to Whole Life Book

Fitch believes 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. For the five-year period ended Dec. 31, 2010, adjusted surplus has grown at a 3% 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.

Low Reliance on Capital Markets

TFC is a nonrisk-based leverage measure that expands on traditional measures of financial leverage to include all forms of debt, including match-funded and other operational debt, as well as debt supporting long-term capital needs and liquidity and working capital needs. During periods of market disruptions, and lost access to capital markets funding, such operational and off-balance sheet commitments can become a direct source of vulnerability to an organization.

NMAA's total financing and commitment (TFC) ratio indicates modest reliance on capital markets for funding compared with its peers. At year-end 2010, Navy Mutual had a low TFC ratio at 0.2x versus the life insurance industry average of 0.6x. The exposure is primarily short-term security lending. Navy Mutual participates in a securities lending program to generate incremental income and had $44 million under loan at year-end 2010.

Financial Performance and Earnings

	2006	2007	2008	2009	2010	Fitch's Expectation
Pretax Gain from Operations ($ Mil.)	13	12	13	20	8	The Association will report good predividend operating performance driven by low expenses, strong levels of investment income, and low credit-related investment losses. Fitch expects the company will generate single-digit operating returns on TAC for 2011.
Net Income ($ Mil.)	14	21	12	10	3	
Pretax Return on Total Assets Post-Dividend (%)	0.64	0.58	0.59	0.86	0.32	
Operating Return on TAC (%)	7.4	6.2	7.0	11.0	3.8	
Growth in Revenues (Before Realized Gains) (%)	(2)	3	10	15	2	

TAC – Total adjusted capital. Note: Excludes realized capital gains/(losses).
Source: NMAA, Fitch.

Solid, Consistent Operating Performance

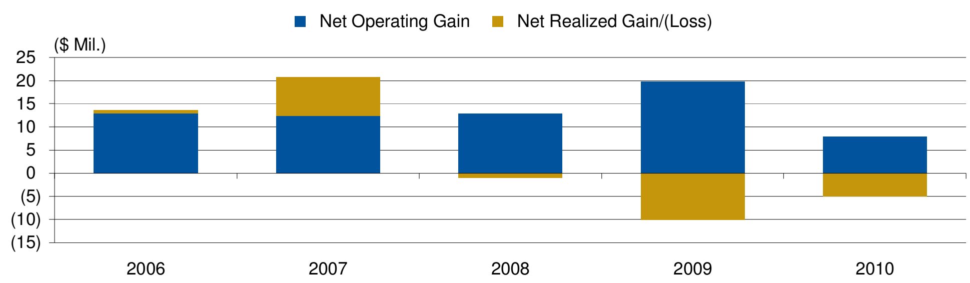
- Consistent, moderate operating profitability.
- Favorable earnings drivers expected to continue.
- Expenses are well-managed and very low.

Fitch views Navy Mutual's operating performance as solid, characterized by consistent, healthy predividend gains from operations. Key drivers are low expense levels, good investment income, and favorable persistency and mortality. Net income declined in 2010 to $3 million as NMAA continues to pay high dividends and premium growth versus the previous year due to lower annuity sales.

Consistent, Moderate Operating Profitability

As a mutual entity, the Association does not generate a significant statutory net operating gain. Navy Mutual allocates revenue in excess of that required by its financial plan for reserve and surplus increases to grow the cash value of its interest-sensitive whole life policies and to provide premium refunds on its term policies.

NMAA — Operating Gains and Realized Capital Gains/(Losses)



Source: Navy Mutual Aid Association.

Favorable Earnings Drivers Expected to Continue

Expenses are well-managed and very low as exhibited by an expense ratio of 0.5% (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 be within pricing expectations and investment income has been strong, reflecting a 6.5% yield consistently over the last five years due to low reinvestment risk and strong credit performance.

Crediting Rate Flexibility

Navy Mutual has demonstrated operating flexibility by modifying its crediting rates to reflect changes in interest rate levels and investment portfolio performance. The Associate continues to pay a high crediting rate to its policyholders in 2011. Crediting rate decisions are normally made once a year, but Navy Mutual has the flexibility to respond to changing interest rates or the need to retain surplus.

Investments and Asset Risk

	2006	2007	2008	2009	2010	Fitch's Expectations
Cash and Invested Assets ($ Mil.)	2,039	2,135	2,192	2,341	2,499	Navy Mutual will maintain a high-quality investment portfolio. Credit-related investment impairments will be low.
Below Investment-Grade Bonds/TAC (%)	19.9	21.4	17.4	19.0	16.0	
Risky Assets Ratio (%)	107.3	94.2	67.8	71	71.5	
Investment Yield (%)	6.6	6.6	6.5	6.5	6.4	

TAC – Total adjusted capital.
Source: NMAA, Fitch.

High-Quality Investment Portfolio Provide Income and Liquidity

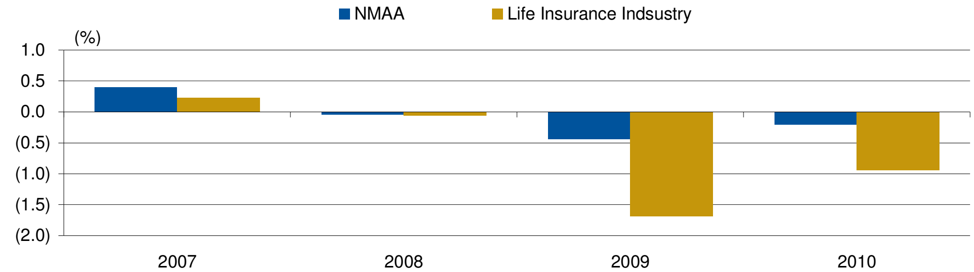
- High credit quality.
- Good performance during crisis.
- Acceptable market risk.

Fitch views the Association's investment performance as good with consistent levels of investment income and strong credit-related performance. Fitch believes the Association's invested assets have low exposure to credit risk and moderate exposure to equity market volatility and changes in interest rate levels. Fitch considers Navy Mutual's investment portfolio to be conservatively managed and the asset mix to be appropriate for its product liabilities and investment strategy. The majority of invested assets are managed internally.

High Credit Quality

Maintaining a high credit quality fixed-income portfolio is a key strategy for Navy Mutual as seen in a below investment-grade bonds (BIGs) to total adjusted capital (TAC) ratio of 16% at year-end 2010 versus the 2010 industry average at 51%. Navy Mutual does not buy BIGs as per its investment policy. Below investment-grade bonds were only 1.6% of the bond portfolio at year-end 2010. Navy Mutual has minimal exposure to commercial mortgages or residential mortgages and no subprime or Alt-A residential securities. In addition, Navy Mutual limits its aggregate investment in common stocks, direct mortgages, and private real estate trusts to 6% of total assets.

Realized Investments Gains/(Losses) to Average Invested Assets



Source: Fitch, NMAA.

Good Performance During Crisis

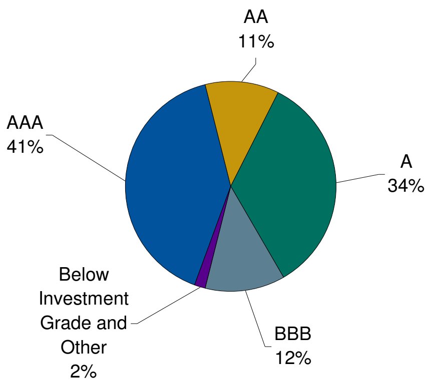
Navy Mutual exhibited strong investment performance over the challenging 2008–2010 period. Fitch expects low credit-related losses and continued strong investment income generation. Navy Mutual's high-quality, fixed-income portfolio continues to generate favorable investment yields due in part to its long duration and low exposure to callable bonds and mortgage-related securities. Realized losses related to credit impairments have been moderate and compare very favorably with the life insurance industry.

Acceptable Market Risk

Fitch notes that changes in year-to-year reported adjusted surplus have experienced moderate volatility over the past five years due to the fluctuating market values of its common stock holdings. At year-end 2010, common stock investment increased to 4.5% due mainly to market appreciation.

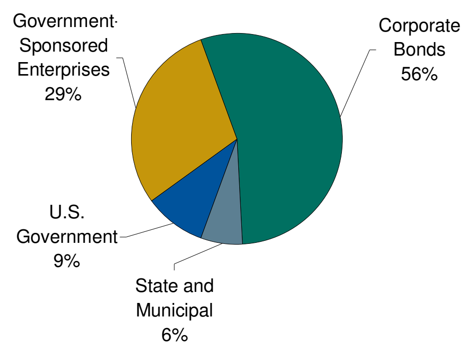
In addition, the Association's long-duration bond portfolio exhibits price risk to a rising interest rate scenario, but it has performed as expected in the declining interest rate scenario. Fitch considers this risk as reasonable since yields on these assets are normally well above the minimum yields required to fulfill the liability requirement, thus minimizing the reinvestment risk. Navy Mutual's bond portfolio typically exhibits a long duration to match the life insurance-dominated liability portfolio.

NMAA Bond Portfolio by Credit Rating



Source: NMAA, Fitch.

NMAA Bond Portfolio by Bond Type
(As of Year-End 2010)



Source: NMAA, Fitch.

Asset/Liability and Liquidity Management

	2006	2007	2008	2009	2010	Fitch's Expectations
Liquidity Ratio (%)	99.9	100.5	97.8	105.5	103.8	NMAA's product portfolio is heavily weight toward life insurance. Fitch expects this to continue.
Operating Cash Flow Coverage (x)	N.A.	N.A.	1.8	1.9	1.8	
Total Adjusted Liabilities and Deposits ($ Mil.)	1,883	1,963	2,068	2,181	2,355	

N.A. – Not available.
Source: Fitch.

Conservative Products and Good Liquidity

- Good liquidity.
- Sound asset liability management.
- Unique mortality risk due to war catastrophe.

Fitch considers Navy Mutual's asset liability management to be sound and its liquidity to be good. Due to NMAA's unique customer base, it has experienced to a limited degree the increasing market-based investment risks experienced by the life insurance industry due to wide shift towards asset accumulation products, typically with some investment guarantees. NMAA has also not followed the trend of increased product complexity, which requires more sophisticated financial management and has increased regulatory and operational risk.

Good Liquidity

The drivers of NMAA's liquidity are the composition of the invested assets and conservative traded securities. Additionally, good levels of cash flow from operations provide an added level of comfort regarding the protection provided to policyholders.

Sound Asset Liability Management

The Association'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 and equity market scenarios to ensure that its cash flow matching is sufficient to mitigate any potential disintermediation. Test results are favorable even under severe interest rate and equity market scenarios.

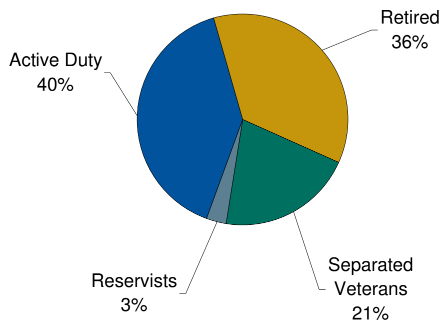
Unique Mortality Risk Due to War Catastrophe

Fitch believes that Navy Mutual's war risk is being prudently managed and mortality experience is within expectations despite the current escalated levels of conflict worldwide in recent years. Navy Mutual estimates that less than 10% of its current in-force book of business is currently eligible for war risk. At year-end 2010, Navy Mutual held $76 million in war risk and other adverse deviation reserves, designed to protect against long-term excess claims due to war and other risks.

Fitch believes that the Association's current war reserves and mortality margins could experience a significant increase in adverse results for a sustained number of years without requiring additions.

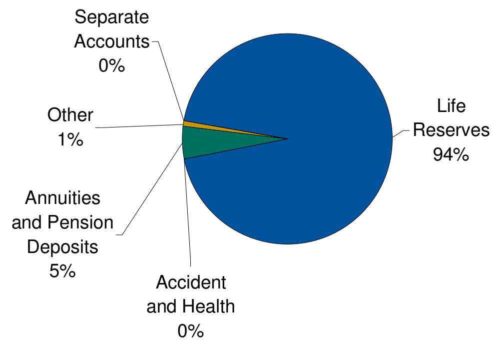
Appendix A: Additional Financial Exhibits

NMAA Member Profile
(YE 2010)



Note: Separated veterans are veterans who have not reach retirement age.
Source: NMAA.

NMAA Adjusted Liabilities and Separate Accounts



Source: Navy Mutual Aid Association.

Appendix B: Other Ratings Considerations

Below is a summary of additional ratings considerations of a “technical” nature, which are also part of Fitch’s ratings criteria.

Notching

The United States is a “strong” regulatory environment with restrictions on payments from the regulated insurance entities to holding companies and priority afforded policyholder obligations.

Notching Summary

IFS Ratings
A baseline recovery assumption of Good applies to the insurer financial strength (IFS) rating and standard notching was used based on the existence of policyholder priority.

Hybrids — Equity/Debt Treatment

Not applicable.

Recovery Analysis and Recovery Ratings

Not applicable.

Exceptions to Criteria/Ratings Limitations

None.

The ratings above were solicited by, or on behalf of, the issuer, and therefore, Fitch has been compensated for the provision of the ratings.