Life Insurers
U.S. and Canada
Full Rating Report

Navy Mutual Aid Association

Ratings

Security Class	Rating
Insurer Financial Strength	A+

Rating Outlook

Stable

Financial Data

Navy Mutual Aid Association

	Date	$ Mil.
Increase in Net Assets from Operations	12/31/09	20.0
Net Assets	12/31/09	175
Debt and Hybrids	12/31/09	0

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Related Research

Applicable Criteria
- *Insurance Rating Methodology, Aug. 16, 2010*
- *Life Insurance Rating Methodology, March 24, 2010*
- *Fitch's Approach to Rating Insurance Groups, March 24, 2010*

Other Research
- *Fitch Affirms Navy Mutual Aid Association's IFS Rating at 'A+', Sept. 27, 2010*
- *U.S. Life Insurance Sector: Outlook Revised to Stable , Sept. 7, 2010*

Rating Rationale

- Navy Mutual Aid Association's (Navy Mutual or the Association) 'A+' insurer financial strength (IFS) rating reflects its very strong capital levels, high-quality liquid investment portfolio, and favorable business profile with a strong niche position as a low-cost provider of life insurance protection products to the U.S. sea services and their families.
- In Fitch Ratings' opinion, Navy Mutual's additional strengths are conservative reserving, excellent persistency, and consistently low expense ratios. Fitch 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.
- 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 or guarantees. Navy Mutual's investment portfolio is composed of more than 30% U.S. government or government-sponsored enterprise debt and high-quality corporate bonds, with no exposure to problematic structured securities. Financial flexibility is considered adequate in respect to Navy Mutual's unique business profile and product portfolio.
- 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. Fitch notes Navy Mutual's risky asset ratio realized credit-related losses compare very favorably with the life insurance industry at year-end 2009.
- Rating concerns include Navy Mutual's limited access to capital markets, moderate volatility in capital driven by common stock investments, and the long-term challenge of membership growth.

Key Rating Drivers

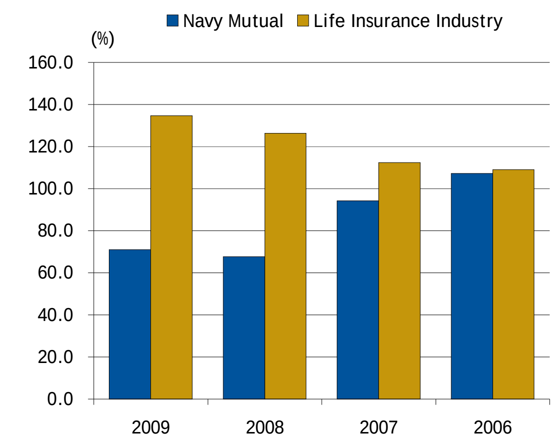
- Fitch expects Navy Mutual will maintain a solid balance sheet in 2010 with strong capital levels and a high-quality liquid investment portfolio. Fitch expects the Association to report good operating performance in 2010, driven by low expenses, strong levels of investment income, and low credit-related investment losses.
- Navy Mutual's ratings are based in part 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. Barring any change in these qualities, Fitch views Navy Mutual at the upper end of that range.
- Within Fitch's rating rationale are key rating drivers. If Navy Mutual was to materially deviate from any of these items, especially for an extended period, the ratings could be affected. Included within these key rating drivers are the following:
  - Net operating earnings of $10 million–$15 million a year.
  - Gross investment losses of less than $25 million in 2010.
  - Estimated risk-based capital (RBC) above 300% company action level.
  - Significant change in war risk exposure and experience.
  - Unfavorable change in tax/regulatory status.

Key Rating Issues

Strong Investment Performance

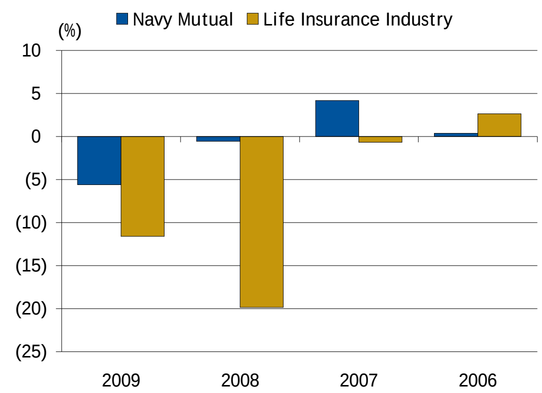
Navy Mutual exhibited strong investment performance over the challenging 2008–2009 period. Fitch expects the Association's investment portfolio performance to continue to be a favorable credit driver in 2010 and 2011 with low credit-related losses and continued strong investment income generation. Navy Mutual'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.

Risky Assets to Total Adjusted Surplus



Source: Navy Mutual Aid Association, Fitch Ratings.

Realized Investment Gains — Losses to Total Adjusted Capital



Source: Navy Mutual Aid Association, Fitch Ratings.

Navy Mutual's unrealized losses are low and the net unrealized gain position was $200 million at year-end 2009. 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.

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 that is consistently below the industry average at less than 20% (the 2009 industry average was 69.7%). The Association realized its first moderate amounts of realized investment losses in 2008–2009 at $21 million, or 49 bps realized investment losses/invested assets, which compares favorably versus an industry level of 269 bps. Navy Mutual does not buy BIGs as per investment policy. Below investment-grade bonds were only 1.9% of the bond portfolio at year-end 2009. Navy Mutual has minimal exposure to commercial mortgages or residential mortgages and no subprime or Alt-A residential securities.

The investment portfolio has good liquidity as 92% of bonds are publicly traded. Navy Mutual in recent years has purchased private placement securities in limited amounts as a way to add incremental yield to its investment portfolio.

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 upon 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.

Fitch views Navy Mutual as serving a unique niche in terms of a customer base and customer services. The Association 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. Financial flexibility is considered adequate in respect to Navy Mutual's unique business profile and product portfolio.

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 to them at that time.

Sustainable Competitive Advantages Provide Stable Profitability

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 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, 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.

Unique Mortality Risk Due to War Catastrophe Is Manageable Despite Higher Policy Limits and Extended Middle East Conflicts

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. Since its inception, Navy Mutual has been exposed to the possibility of catastrophic losses that could result from war. Navy Mutual estimates that less than 10% of its current in-force book of business is currently eligible for war risk. 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. At year-end 2009, 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. War-related death benefits were $0.5 million in 2009 and $4.6 million in 2008, or 0.7% of total death benefits in 2009 versus 7.5% in 2008.

Navy Mutual has solid credit fundamentals and has outperformed many peer-rated companies in the challenging 2008–2009 period.

Peer Analysis

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 considering the Association's high excess policyholder dividends. Fitch notes Navy Mutual's risky asset ratio realized credit-related losses compared very favorably with the life insurance industry at year-end 2009.

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.

Company Profile

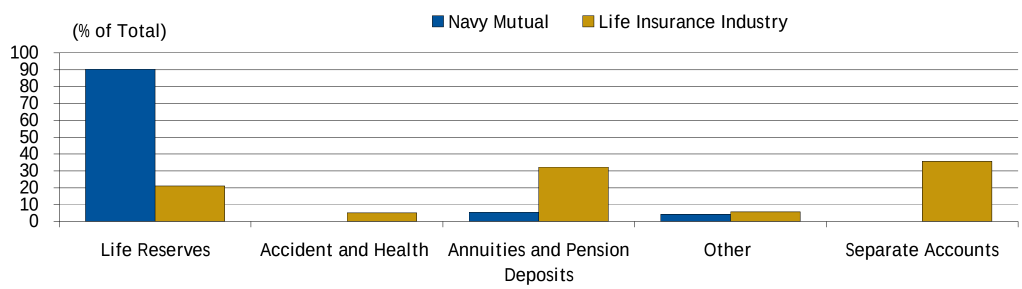
Navy Mutual is a mutual aid association, with eligible membership that currently includes all uniformed personnel of the Navy, Marine Corps, Coast Guard, National Oceanic and Atmospheric Administration (NOAA), and U.S. Public Health Service Commissioned Corps (USPHS), including all enlisted and officer 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.

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 Navy Mutual currently has approximately 100,000 members, about 40% of all members are on active duty in the various services represented in the Association. Fitch believes that the expected future decline in naval manpower could make it more challenging for Navy Mutual to expand its membership base and grow premiums. The Association'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 Navy Mutual, which is positioned as a way to help pay for the costs of a college education.

Navy Mutual serves its defined market with an uncomplicated selection of insurance and annuity product offerings.

Adjusted Liabilities and Separate Accounts — Year-End 2009 Comparison



Source: Navy Mutual Aid Association, Fitch Ratings.

Products

Navy Mutual serves its defined market with an uncomplicated selection of insurance and annuity product offerings. The Association had $20.4 billion of insurance in force at year-end 2009. It also provides related informational services including survivor assistance, financial planning, financial services, 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. 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 Navy Mutual's focus is service to its members whatever their needs.

Navy Mutual has increased 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, 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). 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.

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 death benefit, less any loans, can be converted to an annuity payout for a specified period. This feature also benefits Navy Mutual, 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

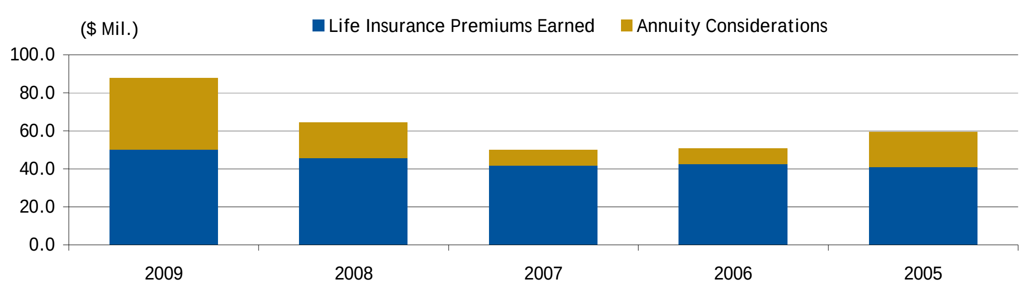
New plans are generated through two main sources: direct marketing and member referrals.

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

Navy Mutual'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, the Association makes approximately 700 presentations to an estimated 28,000 sea service members annually. Educators are not permitted to sell Navy Mutual products. If, after a presentation, a service member is interested in buying a policy from Navy Mutual, 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 Navy Mutual's long-term challenges. 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 strategic plan to increase the communication of its needs-based value proposition, which began in 2006, and continued excellent service and education will have a beneficial effect on new membership levels. Results in 2008 and 2009 have been favorable, as seen in a significant increase in total direct premiums.

Navy Mutual — Direct Premiums



Source: Navy Mutual Aid Association, Fitch Ratings.

Financial Analysis

Profitability

Fitch views Navy Mutual's operating performance as solid, characterized by consistent, healthy predividend gains from operations and good premium growth. Key drivers are low expense levels, good investment income, and favorable persistency and mortality. Operating return on total adjusted capital increased to a five-year high of 11% in 2009. While 2009 net income declined moderately to $10 million from $12 million in 2008, due primarily to $10 million in realized net investment losses, net operating gain was strong at $20 million versus $13 million the previous year. Navy Mutual's revenues increased 15% in 2010 driven by a 39% increase in premiums.

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 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, Navy Mutual could redirect this excess revenue to its surplus base. 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. The Association has demonstrated this flexibility by modifying its crediting rates to reflect changes in interest rate levels and investment portfolio performance. Fitch notes that Navy Mutual continues to pay a high crediting rate to its policyholders.

Fitch views Navy Mutual's operating performance over the past three years as good, characterized by consistent, healthy predividend gains from operations and good premium growth.

Operating Performance

($ Mil.)

	2009	2008	2007	2006	2005
Total Premium Income	89	64	51	52	60
Investment Income	146	139	135	129	123
Total Revenue	236	205	186	181	184
Gain Before Federal Income Tax and Dividend	54	46	44	44	38
Policyholder Dividend	34	33	32	31	29
Pretax Gain from Operations	20	13	12	13	9
Federal Income Tax	—	—	—	—	—
Net Operating Gain	20	13	12	13	9
Realized Capital Gains	(10)	(1)	8	1	18
Net Income	10	12	21	14	27
Total Net Admitted Assets	2,380	2,230	2,172	2,074	1,957
Operating Return on Total Adjusted Capital (%)	11.0	6.8	6.2	7.4	5.9
Pretax Return on Total Assets Pre-Dividend (%)	2.3	2.1	2.1	2.1	2.0
Pretax Return on Total Assets Post-Dividend (%)	0.9	0.6	0.6	0.6	0.5
Pretax Operating Margin (%)	8.4	6.3	6.6	7.2	4.8
Expense Ratio (%)	0.5	0.5	0.4	0.4	0.4
Net Investment Yield (%)	6.6	6.6	6.6	6.7	6.7

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

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 6.6% yield consistently over the last five years due to low reinvestment risk and strong credit performance.

Investments and Liquidity

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. 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. The majority of invested assets are managed internally.

Fitch views the Association's investment performance as good with consistent levels of investment income and strong credit-related performance. The investment yield of 6.6% compared quite favorably with the life industry's average yield of 5.3% at year-end 2009, 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 moderate and compare very favorably with the life insurance industry.

Fitch views the Association's investment performance as strong with consistent levels of investment income and favorable, credit-related performance.

The Association's bond portfolio is composed of very high credit quality assets. Approximately one-third of the bond portfolio was invested in U.S. Treasury and federal agency securities and government-sponsored enterprise securities at year-end 2009. 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 bonds rated 'BBB' to be no more than 15% of the bond portfolio.

Navy Mutual's bond portfolio typically exhibits a long duration to better match the life insurance-dominated liability portfolio. The long duration of assets exposes Navy Mutual 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.

In addition, Navy Mutual limits its aggregate investment in common stocks, direct mortgages, and private real estate trusts to 6% of total assets. At year-end 2009, common stock investment increased to 4% due mainly to market appreciation. Directly placed mortgage loans accounted for only 0.3% of the Association's investment portfolio and all mortgage loans are in a performing status.

Fitch considers Navy Mutual's asset liability management to be sound. 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

Investment Portfolio

($ Mil.)

	2009	2008	2007	2006	2005
Total Invested Assets	2,341	2,192	2,135	2,039	1,924
% Bonds	85.5	88.2	85.6	84.6	84.6
% Common and Preferred Stock	4.0	3.0	6.2	7.4	6.8
% Mortgage Loans	0.6	0.3	0.2	0.2	0.3
% Real Estate	0.2	0.2	0.2	0.2	0.2
% Policy Loans	6.3	6.5	6.4	6.4	6.5
% Cash and Equivalents	3.0	1.1	0.5	0.4	0.4
% Affiliated Investments	—	—	—	—	—
% Other Invested Assets	0.4	0.8	0.9	0.8	1.2
Below Investment Grade/Total Adjusted Capital (TAC) (%)	19.0	16.5	21.4	19.9	23.1
Troubled Real Estate/Total Adjusted Capital (%)	—	—	—	—	—
Unaffiliated Common Stock/Total Adjusted Capital (%)	47.1	38.8	64.0	78.9	82.6
Schedule BA Other Invested Assets/TAC (%)	5.0	9.1	8.8	8.5	15.1
Risky Assets Ratio (%)	70.1	64.5	94.2	107.3	120.8

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

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

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. 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 Navy Mutual's liquidity is 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. Navy Mutual'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 the Association. Additionally, good levels of cash flow from operations provide an added level of comfort regarding the protection provided to policyholders.

Capitalization

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.

Fitch views Navy Mutual's estimated statutory risk-adjusted capital ratio as solid at approximately 360% of the company action level at year-end 2009. 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. When capital was stressed for potential 2010 investment losses under Fitch's core investment stress, Navy Mutual's statutory capital was viewed as solid for the rating.

Fitch views Navy Mutual's estimated statutory risk-adjusted capital ratio as solid at approximately 360% of the company action level at year-end 2009.

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.

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. Fitch believes the Navy Mutual's investment allocation modifications have a favorable effect upon this volatility.

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, 2009, adjusted surplus has grown at a 6.8% 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 notes that under its newly introduced total financing and commitment (TFC) ratio, Navy Mutual demonstrates modest reliance on capital markets for funding compared with its peers. At year-end 2009, 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 $35 million under loan at year-end 2009 versus $129.8 million under loan at year-end 2008.

Capitalization

($ Mil.)

	2009	2008	2007	2006	2005
Beginning-of-Period Total Adjusted Capital	161	208	192	158	144
Net Operating Gain	20	13	12	13	9
Net Realized Gain/Loss	(10)	(1)	8	1	18
Change in Unrealized Gain/Loss	23	(58)	—	20	(13)
Change in Reserve Valuation	7	—	—	—	—
Paid-in Capital/Surplus	—	—	—	—	—
Dividends to Stockholders	—	—	—	—	—
Other Changes	(1)	1	(4)	—	—
Total Changes	38	(47)	16	34	14
End-of-Period Total Adjusted Capital	200	161	208	192	158
Statutory Surplus	175	140	179	163	133
Asset Valuation Reserve	25	21	30	28	25
1/2 Policyholders' Dividends	—	—	—	—	—
Regulatory Capital (Total Adjusted Capital)	200	161	208	192	158
Assets/Statutory Surplus (x)	13.6	15.9	12.2	12.7	14.7
Adjusted Liabilities/Statutory Surplus (x)	12.5	14.8	11.0	11.5	13.5

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