

How The Economic Environment and Credit Crisis Are Impacting The Life Insurance Industry

Grace Osborne, CPA, Managing Director
Greg Gaskel, Director
Kevin Ahern, Senior Director

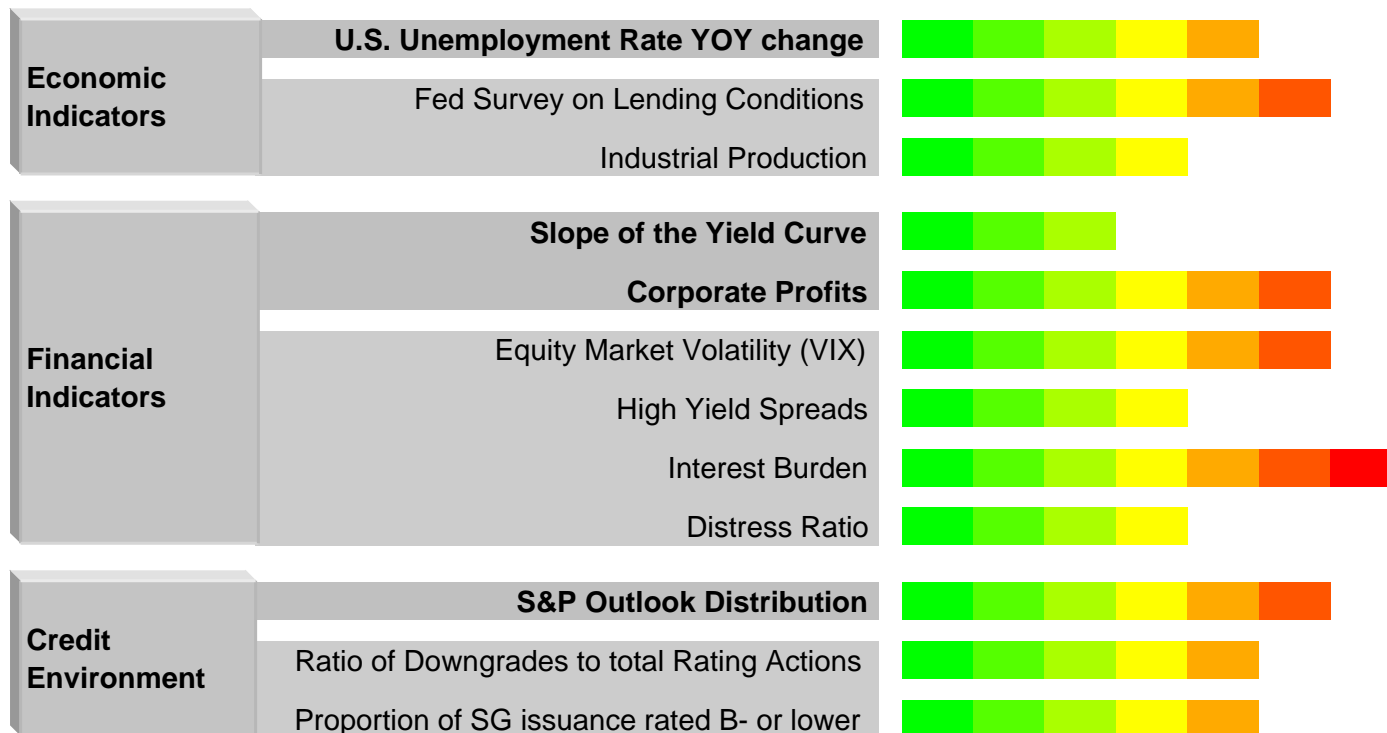
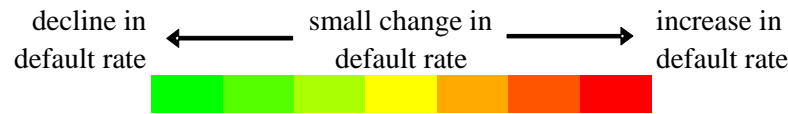
October 19, 2009

Permission to reprint or distribute any content from this presentation requires the prior written approval of Standard & Poor's.
Copyright (c) 2009 Standard & Poor's, a subsidiary of The McGraw-Hill Companies, Inc. All rights reserved.

Key Takeaways

- **US Corporate Default rates hit double digits (10.3% as of September 2009) for the first time since 2002**
- **Unprecedented trough-to-peak increase when compared to a 25-year low of 0.98% in Dec. 2007**
- **Baseline default forecast (60% probability) is 13.9% in next 12 months, indicating 197 speculative grade issuers will likely default in this period**
- **Default rate expected to escalate through the initial recovery period in Q1 2010, and then inch lower by June 2010**
- **Although conditions have improved for debt issuances, support for weaker speculative grade companies remains questionable**
- **Given the sharp hit to consumers in this downturn, consumer discretionary expected to be at the forefront of the default wave**

U.S. Default Surveillance Toolkit



Risks to default rate reflect a one-year time horizon for all variables from the distress ratio, which reflects a 9-month time horizon.

Source : Standard & Poor's Global Fixed Income Research. Data as Sept. 15, 2009.

2009 Global Corporate Default Highlights

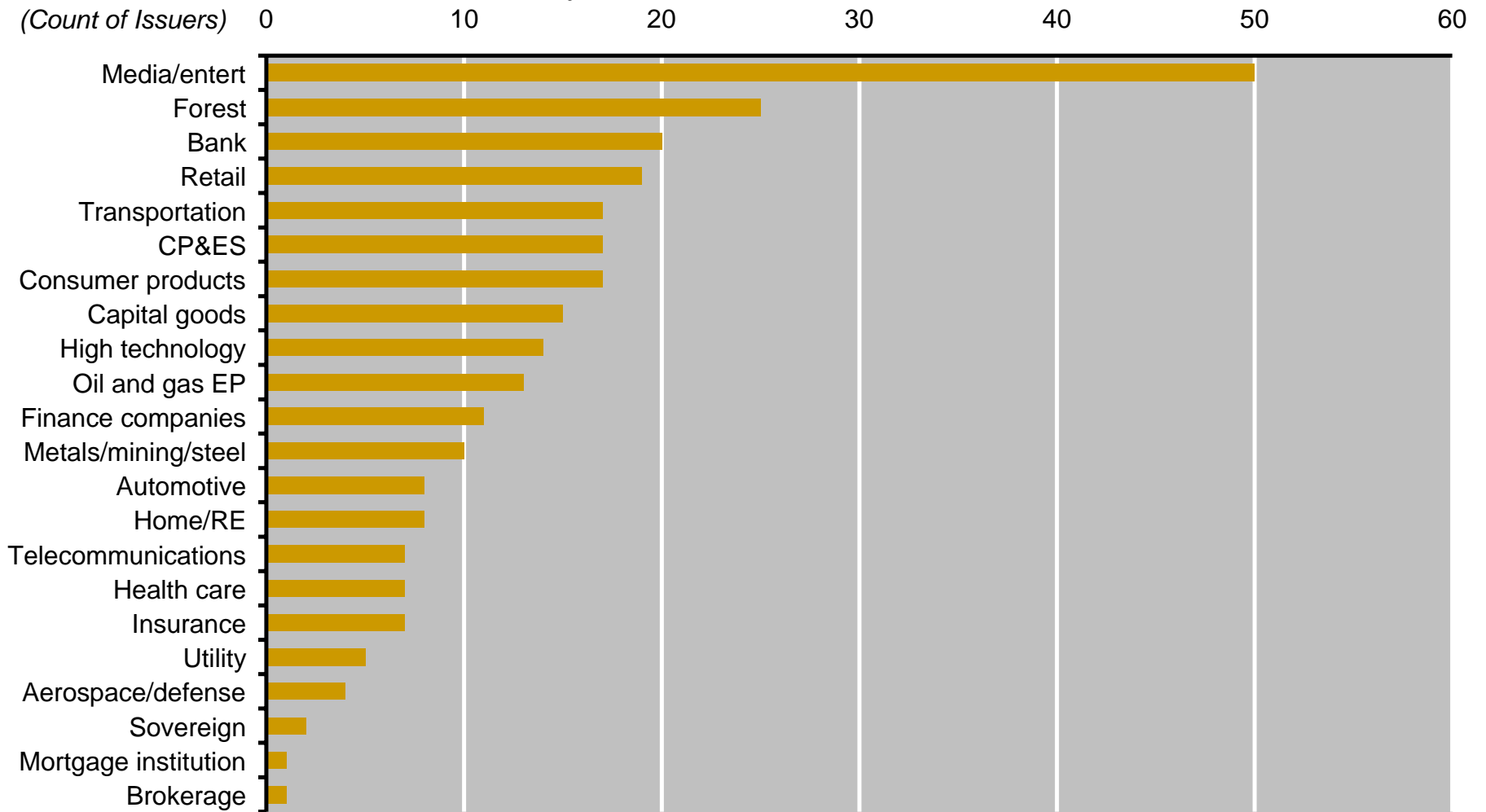
- **215 issuers defaulted in 2009, nearly 4x the defaults in 2008**
- **Distressed exchanges and missed interest payment are main reasons for default**
- **Of the global defaulters in 2009, 40% had recovery ratings of '6' (10-20% recovery), and only 10% had recovery ratings of '1' (90-100% recovery)**
- **Sharp increase in corporate bankruptcies pose significant difficulties to private equity investors**
- **Emerging markets outlook has regained some of its luster, though mostly supported by interventionist measures**

Domestic Drivers for Higher U.S. Corporate Defaults

- **Recessionary conditions in the U.S.**
- **Tighter lending conditions and heightened credit-risk volatility, which have caused a substantial hike in the cost of capital**
- **A greater proportion of speculative-grade issuers than at any other point in history**
- **Greater impact of seasoning in the 'B-' or lower rating categories**

Next Class Of Defaulters

Subsector Distribution of Weakest Links By Number of Issuers



Media/entert - Media and entertainment, Forest -Forest products and building materials, Retail - Retail/restaurants, CP&ES-Chemicals, packaging, and environmental services, Oil and gas EP-Oil and gas exploration and production, Metals/mining/steel - Metals, mining, and steel, Home/RE- Homebuilders/real estate companies, Aerospace/defense- Aerospace and defense. Data as of Sep. 11, 2009.

Source: Standard & Poor's Global Fixed Income Research



S&P View: Lower Grade Corporate Issuers Likely to Lead to Increased Default Supply

Distribution of First-Time Issuers in the U.S.

<u>Year</u>	<u>AAA</u>	<u>AA</u>	<u>A</u>	<u>BBB</u>	<u>BB</u>	<u>B</u>	<u>CCC and below</u>	<u>Total new issuers</u>	<u>IG share</u>	<u>SG share</u>
2000	2	12	35	50	42	85	6	232	43%	57%
2001	4	7	33	65	44	38	2	193	56%	44%
2002		2	20	40	70	66	7	205	30%	70%
2003		3	16	32	57	101	8	217	24%	76%
2004		3	11	36	52	198	14	314	16%	84%
2005	1	3	17	26	54	214	5	320	15%	85%
2006	1	14	24	38	49	226	2	354	22%	78%
2007		10	14	35	46	245	6	356	17%	83%
2008	1	19	12	30	19	58	7	146	42%	58%
2009			7	5	4	23	25	64	19%	81%

Source: Standard & Poor's Global Fixed Income Research, Standard & Poor's CreditPro®.
As of June 30, 2009. Includes parent and subsidiary level issuers. IG – investment-grade, SG – speculative-grade.

Across All Industries

Speculative Grade Share Of U.S. Nonfinancials

Sector	% Of Issuers Rated Speculative Grade			
	1981	1991	2001	2008
Total nonfinancial	25	33	50	63
Total financial	13	15	8	14
Aerospace / automotive / capital goods / metal	34	45	68	72
Consumer / service sector	30	41	54	71
Energy and natural resources	34	32	61	62
Forest and building products / homebuilders	26	44	58	75
Health care / chemicals	24	36	59	73
High technology / computers / office equipment	49	68	62	75
Leisure time / media	43	66	75	89
Real estate	42	13	17	26
Telecommunications	3	3	64	75
Transportation	28	29	45	60
Utility	4	4	9	12

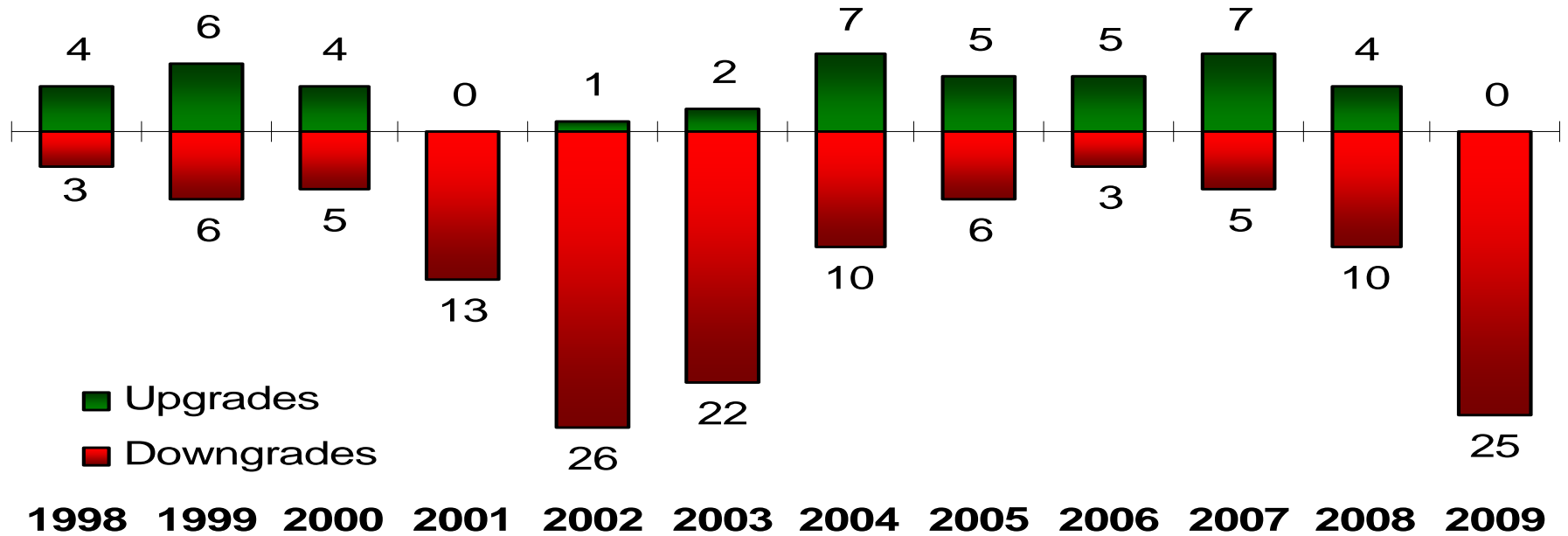
Source: Standard & Poor's Global Fixed Income Research, Standard & Poor's CreditPro®.



Permission to reprint or distribute any content from this presentation requires the prior written approval of Standard & Poor's.

Life Insurance Sector – Current State

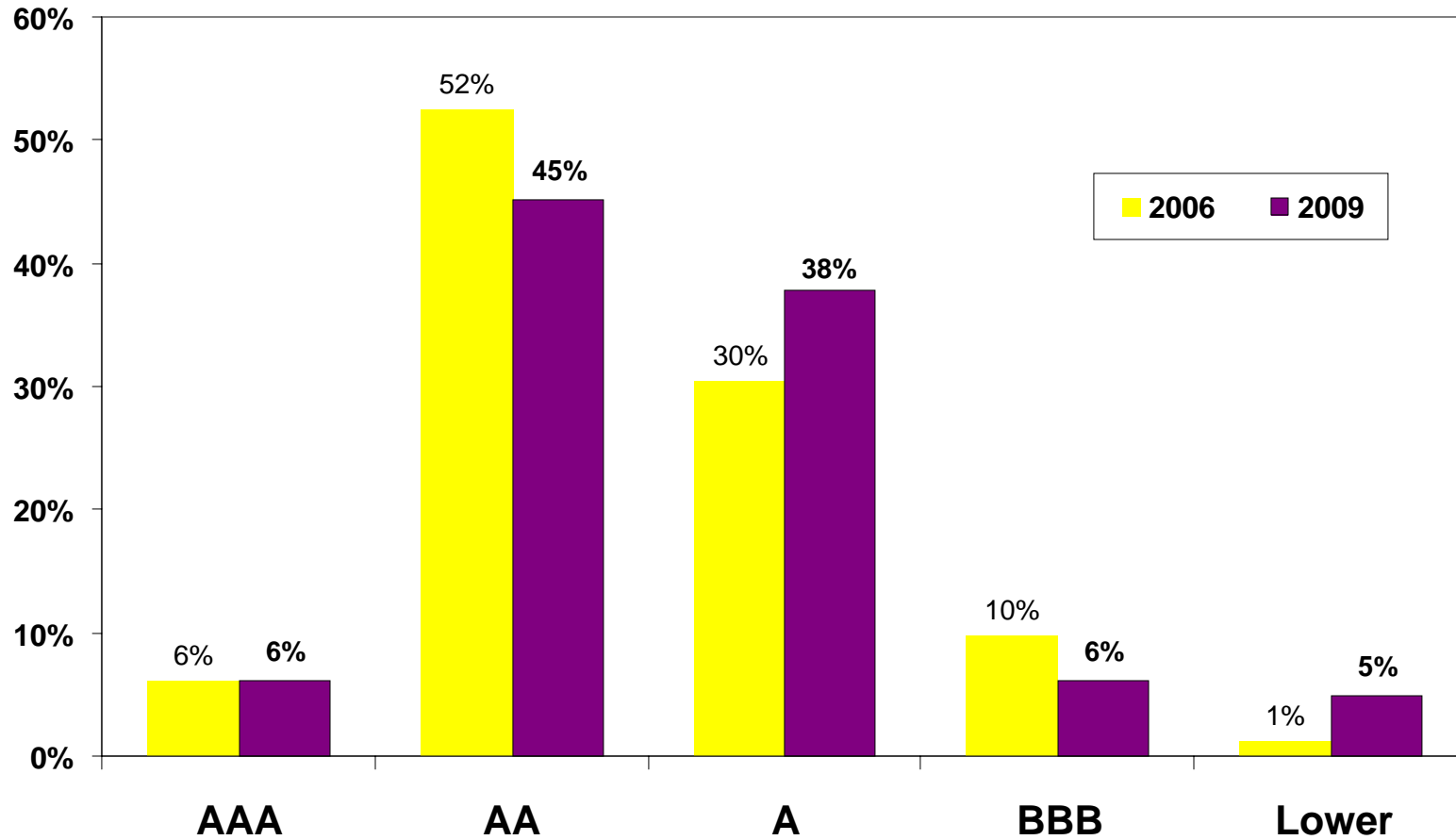
Rating Trends: U.S. Life Insurance



2009 Totals through 9/3/09; Multiple rating actions within a given year are included

Permission to reprint or distribute any content from this presentation requires the prior written approval of Standard & Poor's.

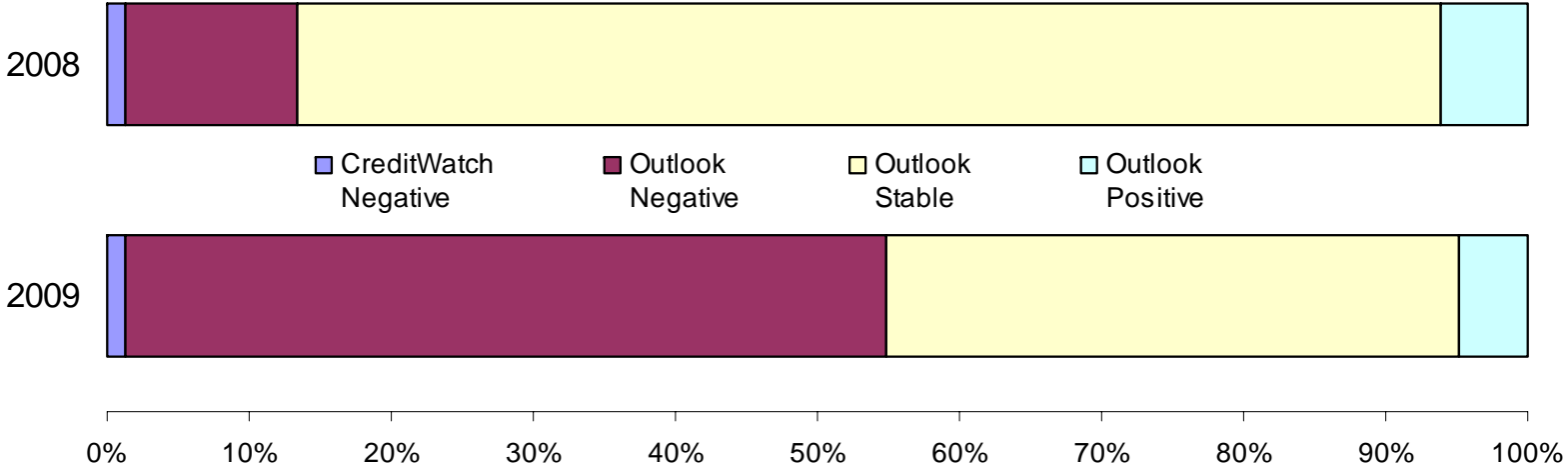
Rating Distribution: U.S. Life Insurance



Ratings of 82 interactively-rated companies and groups as of September 3, 2009 looking backward to 2006.

Permission to reprint or distribute any content from this presentation requires the prior written approval of Standard & Poor's.

Rating Outlooks: U.S. Life Insurance



As of 9/3 of each year.



US Life Outlook Is Negative (Current Drivers)

- **Higher than expected credit defaults**
 - Investment grade bonds
 - Below investment grade bonds
 - RMBS / CMBS
 - Commercial real estate
- **Equity market levels and volatility**
 - Direct exposure
 - Indirect exposure / product driven
- **Reduced, but improving, financial flexibility**
 - Financial services companies not attracting capital

Corporate Bonds

- **Investment & Below investment grade**
- **Subsectors with the most exposure**
 - Retail
 - Restaurants
 - Media and Entertainment

Commercial Real Estate

- **Increased losses expected given current unemployment trends**
- **CMBS vintages 2005-2008 under pressure given property valuations**
- **Refinancing risk is paramount in 2010 and 2011**
- **Commercial whole loans are performing in line with expectations but general macro economic factors will likely affect loss performance**

Equity Market Volatility

Two Key Forms of Equity Exposure: Direct & Indirect via Product

- **Direct:** Not the predominate risk, but significant impact for some
- **Indirect:**
 - Impact on Earnings:
 - Reduced fee income from lower assets under management
 - Acceleration of deferred acquisition costs (DAC) on a GAAP basis
 - Higher hedge costs
 - Sales correlate to market performance
 - Impact on Capital:
 - Increase reserving on death benefit guarantees
 - C-3 Phase II
 - Impact on Liquidity:
 - Should be minimal
 - Surrender at market value, which may reduce net amount at risk

Reduced Financial Flexibility

- **Systemic concern for financial firms**
 - Market access and efficiency reduced, but accessibility has improved
 - Overall liquidity in market has been depressed
- **In our view, funding requirements are manageable but pressure is increasing**
 - Growing level of debt maturities in second half of 2009 and in 2010
 - Commercial paper outstanding is modest
 - Bank options are limited
 - Net worth covenant levels are well positioned
 - Securitization market is limited
 - Securities lending program well matched from an ALM standpoint
- **Signs of improvement in financial flexibility**
 - About \$12 billion raised through stock and debt offerings in 2009
 - About \$4-5 billion raised by larger Life Insurance companies through government aid such as TARP funds

Life Insurance Sector Outlook

Prospective Outlook Drivers

- **Competitive Positioning**
 - Rationalizing markets and segment given recent downturn
 - Changes in benefit structures
- **Operating Performance**
 - Impact of re-pricing and repositioning on profitability and coverage
 - Compressed margins given derisking of assets
- **Capitalization**
 - Relative loss performance compared to S&P's incremental asset stress analysis
 - Impact of improving financial flexibility reflecting sector's resiliency and receptivity from capital markets
- **Fallout of Real Estate impact is yet to be determined**
- **Impact of potential accounting changes**

Competitive Positioning

- **Protection Products (Life insurance)**

- Term – demand down due to discretionary purchase
- UL – demand remains due to estate tax planning but pressured by NLSG
- Overall industry sales down close to 28%
- Cost of capital increasing on excess reserve funding
- Lower face amount of insurance purchased due to economic pressure

- **Accumulation Products (Annuities)**

- Align favorably for demographic shift given decline in net worth
- VA guarantees in demand despite higher costs/lower benefits
- Fixed annuities growth strong in first half of 2009 slowed by recent tightening of credit spreads

Operating Performance

- **Impact of repositioning of products**
- **Derisking of assets and higher liquidity will likely impact overall yields and profit margins in 2009**
- **Cost of funding for excess reserves**
- **Lower margins will likely drive lower fixed charge coverages on debt**

Capitalization

- **Expected stress investment losses to actual losses**
- **Impact of new business growth on capital levels**
- **Commercial real estate performance expected to lag economic recovery**

Potential Accounting Changes

- **Permitted practices**
- **VA CARVM**
- **Statutory proposed impairment guideline (SSAP 43R)**
- **IASB/FASB review of insurance contracts**

Despite Concerns, Core Strengths Remain

We Believe Strong Fundamentals Remain Intact But Continued Market Pressures May Impact Ratings Downward

The outlook for the industry is negative, but in our opinion the sector's strong fundamentals remain intact. If ratings were negatively affected, the ratings would likely be one to two notches, at most. Key strengths are:

(+) Relatively stable insurance cash flows from mortality, morbidity and expense performance - long dated liabilities

(+) Strong liquidity profile due to surrender charge protected liabilities and highly marketable investment portfolio

(+) Well positioned to capture opportunities in the retirement market

(+) Systematic need for protection and wealth accumulation

Questions

STANDARD & POOR'S

Copyright© 2009 by Standard & Poor's Financial Services LLC (S&P) a subsidiary of The McGraw-Hill Companies, Inc. All rights reserved. No part of this information may be reproduced or distributed in any form or by any means, or stored in a database or retrieval system, without the prior written permission of S&P. S&P, its affiliates, and/or their third party providers have exclusive proprietary rights in the information, including ratings, credit related analyses and data, provided herein. This information shall not be used for any unlawful or unauthorized purposes. Neither S&P, nor its affiliates, nor their third party providers guarantee the accuracy, completeness, timeliness or availability of any information. S&P, its affiliates or their third party providers and their directors, officers, shareholders, employees or agents are not responsible for any errors or omissions, regardless of the cause, or for the results obtained from the use of such information. S&P, ITS AFFILIATES AND THEIR THIRD PARTY PROVIDERS DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE. In no event shall S&P, its affiliates or their third party providers and their directors, officers, shareholders, employees or agents be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs) in connection with any use of the information contained herein even if advised of the possibility of such damages.

The ratings and credit related analyses of S&P and its affiliates and the observations contained herein are statements of opinion as of the date they are expressed and not statements of fact or recommendations to purchase, hold, or sell any securities or make any investment decisions. S&P assumes no obligation to update any information following publication. Users of the information contained herein should not rely on any of it in making any investment decision. S&P's opinions and analyses do not address the suitability of any security. S&P does not act as a fiduciary or an investment advisor. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of each of these activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P's Ratings Services business may receive compensation for its ratings and credit related analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.standardandpoors.com (free of charge) and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third party redistributors. Additional information about our ratings fees

is available at www.standardandpoors.com/usratingsfees.

STANDARD & POOR'S and S&P are registered trademarks of Standard & Poor's Financial Services LLC