April 14, 2015

The Honorable Brian Boquist
Chair, Senate Committee on Veterans
and Emergency Preparedness
Oregon State Senate
900 Court St. NE
S-305
Salem, OR 97301

Dear Senator Boquist:

On behalf of the Navy Mutual Aid Association ("Navy Mutual"), I am writing to request passage of Senate Bill 781 to clarify Navy Mutual's regulatory status in Oregon. As Navy Mutual's General Counsel and Vice President for Governmental Affairs, I am well-positioned to explain why Senate Bill 781 is required for Navy Mutual to continue its good work on behalf of military families in your state.

Background

Navy Mutual is an unincorporated, non-profit mutual aid association and congressionally-chartered veterans service organization that provides members of the Sea Services (Navy, Marine Corps, Coast Guard, National Oceanic and Atmospheric Administration, and U.S. Public Health Service Commissioned Corps) with life insurance and survivor benefits at the lowest possible net cost. Navy Mutual was formed in 1879 to provide these benefits to Civil War veterans and their families, and it is still performing this important mission today.

Navy Mutual operated for decades under the presumption that it was exempt from insurance regulation under § 748.601(1)(b) of the Oregon Insurance Code, which exempts from regulation "[o]rders, societies or associations that admit to membership only persons engaged in one or more crafts or hazardous occupations, in the same or similar lines of business, insuring only their own members and their families…" In late 2013, however, we were contacted by the Oregon Insurance Division ("OID") about our presence in Oregon. It is our understanding, based on discussions with OID representatives, that OID does not believe that § 748.601(1)(b) applies to Navy Mutual. Accordingly, with OID's knowledge and consent, Navy Mutual has voluntarily ceased selling insurance in Oregon while it seeks to amend § 748.601 to treat Navy Mutual like other exempt benefit associations who provide services to members of hazardous occupations.

Navy Mutual's Regulatory Status

In its 136-year history, Navy Mutual has never been required by any state to be licensed as an insurance company. Just as in Oregon, Navy Mutual has operated nationwide under the states' regulatory exemptions for fraternal benefit societies whose members are engaged in "hazardous occupations." Several states – Florida, Minnesota, and Georgia among them – have confirmed that they consider Navy Mutual to be exempt from regulation under such provisions in their fraternal codes.

Over the years, however, some states have asked for legislative clarification. In the 1990s, Navy Mutual was contacted by the Department of Insurance in its domiciliary state, Virginia. After an informal hearing, the Virginia department recognized the public policy benefits of making Navy Mutual's unique products and survivor services available to Sea Service members, but concluded that Navy Mutual did not fit neatly under the "hazardous occupation" exemption in Virginia's fraternal code. The Virginia department assisted Navy Mutual in asking the Virginia legislature to add the following express exemption from regulation to Virginia's insurance code:

> Any association, whether a fraternal society or not, which was organized before 1880 and whose members are officers or enlisted, regular or reserve, active, retired, or honorably discharged members of the Armed Forces or Sea Services of the United States, and a principal purpose of which is to provide insurance and other benefits to its members and their dependents or beneficiaries.[1]

At that time, Navy Mutual believed that Virginia's position was unique. In 2005, however, Navy Mutual received an inquiry from the North Carolina Department of Insurance. During the inquiry, a lawyer from the North Carolina Attorney General's Office informally opined that Navy Mutual did not meet the letter of that state's "hazardous occupation" exemption. We therefore sought legislative clarification, again with the support of the Department of Insurance. In 2007, the North Carolina state legislature amended the state's insurance code to expressly exempt Navy Mutual from regulation.[2]

While Navy Mutual continues to believe that it falls within the longstanding "hazardous occupations" exemption in the states' fraternal codes, we have begun proactively to seek clarification of our regulatory status. Thus far, we have successfully obtained express regulatory exemptions similar or identical to those granted in Virginia and North Carolina in Arizona, Connecticut, Hawaii, Maryland, Rhode Island, and South Carolina. The only reason that we have not previously approached Oregon is that fewer than 1% of our members reside there.

In states where this issue has arisen, it has been addressed as a technical clarification of the states' "hazardous occupation" exemptions. No state has ever taken the position that Navy Mutual was not entitled to an exemption, or that Navy Mutual should be treated differently from fraternal benefit organizations whose members are engaged in hazardous occupations.

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[1] Va. Code Ann. § 38.2-4135(A)(9).

[2] *See* N.C. Gen. Stat. § 58-24-185(a)(6).

Navy Mutual's Unique Value to Members

Navy Mutual insures only military members and their families, and provides them with many benefits that are not offered by commercial insurance companies. Thanks to our non-profit status, our exemption from insurance regulation and federal income taxes, and the fact that we do not pay agent commissions or shareholder dividends, Navy Mutual can provide life insurance at exceptionally low cost to members of the military whether they are on active duty, retired or in the reserves. Our products are simple – we sell only life insurance and fixed annuities. None of our products is variable or equity-indexed. Our insurance has no loads, no hidden fees, no war, aviation or terrorism clauses, and no limits on coverage based on duty assignment, overseas travel or rank. We are able to offer full coverage even to active duty Navy SEALs serving in Afghanistan. We also represent veterans and their families in benefits claims before the Veterans Administration at no cost to them, educate active duty service members who are transitioning into civilian life, maintain a fireproof vault where our members can store important documents, and provide compassionate, personal support to beneficiaries when our insureds pass away.

In offering membership to Sea Service personnel, Navy Mutual serves a uniquely deserving population that routinely puts itself in harm's way to defend our country. Our members can have tremendous difficulty obtaining life insurance beyond that offered by the federal government. To the extent Navy Mutual's members are even able to buy life insurance from commercial insurers, that insurance is likely to be expensive and capped at low levels. By contrast, Navy Mutual's mission is to aid our servicemen and women by insuring them precisely *because* their service is hazardous. As the Deputy Under Secretary of Defense observed, Navy Mutual is "truly unique … never a breath of scandal … truly part of the defense establishment."[3] In the past few years, Navy Mutual has paid numerous claims to the families of Navy SEALs and Marines who were killed in combat in Iraq and Afghanistan. We do not believe that commercial insurers would have provided those brave combatants with similar coverage.

In recognition of its unique service to the military community, Congress has granted Navy Mutual a special federal tax exemption under §501(c)(23) of the Internal Revenue Code. That exemption was granted in recognition of the "vital service" that Navy Mutual has provided to military families.[4] Similarly, the National Association of Insurance Commissioners included in its model regulation on sales to the military an express exemption for life insurance products sold by 501(c)(23) tax exempt organizations, and that exemption has been adopted by insurance regulators nationwide, including the Oregon OID.[5] Eight other states, including Navy Mutual's domiciliary Commonwealth of Virginia, have already adopted legislation similar or identical to SB 781. Thus, ample precedent exists to support this legislative clarification.

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[3] Excerpt of the Final Report of the Deputy Under Secretary of Defense on Insurance Solicitation Practices on Department of Defense Installations (2000), Exhibit A.

[4] *See* Letter of John J. Duncan, Exhibit B.

[5] OAR § 836-080-0755(2)(g) and (3).

Navy Mutual Serves Responsibly

Navy Mutual is not without regulatory supervision. Our exemptions in Connecticut and Rhode Island require us to submit our audited financial statements to the state insurance departments each year. In Arizona, we also submit our actuarial opinion and memorandum – just as we would in Oregon under SB 781 – and we provide courtesy copies of those materials to the Virginia Department of Insurance as well. Those exemptions allow the insurance commissioners to confirm our continued financial strength, and give them authority to step in if they believe additional reserves are needed.

Navy Mutual is also subject to federal oversight. Our offices are located on Joint Base Fort Myer, Henderson Hall in Arlington, Virginia with the express permission of the Department of the Navy; should Navy Mutual engage in misconduct, we could reasonably expect to lose access to our building. Navy Mutual is exempt from federal income tax under Section 501(c)(23) of the Internal Revenue Code; should the Internal Revenue Service conclude that it had departed from its mission or acted contrary to law, Navy Mutual would likely lose its tax exemption. Navy Mutual is bound by federal laws enforced by the U.S. Securities and Exchange Commission, as well as the consumer protection and other business laws of the several states.

Additionally, Navy Mutual voluntarily undergoes rigorous external review to ensure its continued ability to serve its members and their families for decades to come. For example:

- Navy Mutual undergoes an annual financial audit by an independent CPA firm that specializes in insurance accounting. The firm audits Navy Mutual's financial records, reviews its processes, practices and internal controls, and confirms its compliance with its investment policy, bylaws, applicable law and statutory accounting requirements.

- Navy Mutual submits to a full annual review by the Fitch Ratings, Inc., which has granted Navy Mutual an A+ rating with a stable outlook for the last ten years.[6]

- Our Chief Financial Officer uses the Milliman actuarial consulting firm to review his annual actuarial opinion and memorandum. Milliman also supports Navy Mutual's reserving, cash flow and scenario testing, and other actuarial analysis.

- The Chief of Naval Operations and the Commandant of the Marine Corps are invited to send their direct reports to observe and participate in meetings of Navy Mutual's Board of Directors as service liaisons. Those liaisons have full access to all Board materials, including Navy Mutual's financial statements and governing documents.

- Navy Mutual uses outside technical consultants to assist in the selection and installation of all technology, including its policy administration system. Outside specialists are also used to test the integrity of our IT systems through periodic cyber-security audits.

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[6] *See* 2014 Fitch review, Exhibit C.

- Our legal department makes regular use of the Venable LLP law firm and local counsel to consult on legal matters.

Navy Mutual is also careful to maintain best business practices in its internal operations:

- Navy Mutual's operations are actively overseen by a volunteer Board of Directors made up entirely of respected current and retired Sea Service officers who care deeply about military families and are committed to conservative business practices.

  - The Board's Audit and Finance Committee regularly inspects Navy Mutual's financial statements and investment reports, sets and oversees compliance with Navy Mutual's investment policies, and receives the annual actuarial opinion and report of the independent auditors.

  - The Board's Governance Committee ensures that Navy Mutual complies with its bylaws and prescribed policies and procedures, and that the Board fulfills its fiduciary responsibilities.

  Board members are selected based on their business and financial acumen as well as their distinguished service history and familiarity with Navy Mutual, and are duly elected by the membership. Our future leadership will be recruited from the same military community, so there is no cause for concern that our values will change.

- Our Vice President of Operations regularly audits Navy Mutual's practices by conducting workflow investigations, walking the company's processes, reviewing all exception reports, and spot-checking individual documents for compliance with the association's policies.

- Navy Mutual participates in best-practice industry groups such as LOMA, a respected provider of insurance education and industry statistics, and the International Institute of Business Analysis, and incorporates recommended best practices into its operations.

- Navy Mutual conducts regular enterprise risk management analyses and adjusts its practices to minimize risk in all areas of the association.

- Navy Mutual's processes, policy statements and illustrations comply with applicable Internal Revenue Service regulations as well as model regulations issued by the National Association of Insurance Commissioners.

Navy Mutual is financially strong, with more than $2.6 billion in assets. There is not and never has been any risk to Navy's Mutual's insured members and families. Our insurance and benefits contracts have always been honored.

Legislators need not be concerned with Navy Mutual's market conduct. Our oldest active policy in Oregon dates back to 1937, and we have made our insurance available to Sea Service members in Oregon for 136 years. In all that time, there has been only a single consumer complaint, which has been resolved. Navy Mutual can be relied upon to continue to provide honest, dependable service to Oregon's military families.

In fact, Navy Mutual enjoys exceptionally strong relationships with its members. We routinely conduct member and beneficiary satisfaction surveys, and invariably receive outstanding results. LOMA has performed our yearly customer satisfaction surveys since 2010. A portion of the 2014 LOMA survey narrative stated the following:

- "As in past surveys, results of the 2014 Navy Mutual Customer Satisfaction study indicate very high levels of appreciation for the company. The various measures of customer satisfaction and loyalty included in the survey all receive extremely high ratings that in many cases are close to the 90% mark."

- "As has been mentioned over the years, Navy Mutual has been successful in achieving a level of customer experience that any insurance company would admire."

Less formally, our members routinely provide us with praise. Here are some representative comments:

- "Thank you so very much for your excellent customer service. Your prompt replies with the information requested have been much appreciated!"

- "Mahalo! For your speedy assistance for your team's unfailing support to service members and their families."

- "Your association rationally approaches simple problems with simple solutions. This type of personalized service is exactly why I have enjoyed NMAA membership for some 38 years and have always recommended its advantages to other military members."

- "It has been a genuine pleasure doing business with you. Your service is the finest that I know of, anywhere."

Ultimately, the most important purpose of life insurance is to provide for the insureds' loved ones after they pass away. Navy Mutual works hard to take care of our beneficiaries, who respond to our yearly surveys with comments like these:

- "Everything was astonishingly easy!"

- "Navy Mutual was the only thing that went perfect."

- "You guys are top notch – that comes from a career CLU with Northwestern Mutual, keep up the good work."

- "Amidst all other paperwork and claims, phone calls etc. Navy Mutual was one that was most straight forward, simple and clear."

In the past two years alone, Navy Mutual has paid out over $3.5 million in life insurance benefits to Oregon residents. Passage of SB 781 would allow us to continue to offer reliable life insurance benefits to military families in your state.

SB 781 Establishes a Reasonable Regulatory Framework

SB 781 was developed in consultation with the OID, and we understand that OID has no objection to its passage. The bill is essentially identical to the regulatory exemption granted to Navy Mutual in Arizona in 2013, and is somewhat more rigorous than exemptions that have been in place in other states for many years without incident. It establishes a formal line of communication between Navy Mutual and the OID, and provides the OID with the necessary information to confirm Navy Mutual's continued financial solvency. Should the OID determine that Navy Mutual's reserves need to be strengthened, SB 781 would authorize the OID to require Navy Mutual to set additional funds aside or cease doing business in Oregon.

SB 781 also protects consumers, requiring clear disclosure of Navy Mutual's regulatory status and exemption from Oregon's insurance guaranty fund. We believe that these provisions will be more than sufficient to protect Oregon's military families while permitting them to take advantage of the outstanding products and services that Navy Mutual has offered to its members since 1879.

SB 781 will not open a floodgate for other insurers. To our knowledge, only one other association would be eligible for exemption under SB 781.[7] Please also bear in mind that Navy Mutual seeks exemption only from the technical requirements of Oregon's insurance regulations. We respect and will fully comply with all other applicable state laws, including consumer protection requirements.

SB 781 is required for Navy Mutual to resume sales in Oregon. Never having been subject to full regulation, our business has been designed to provide maximum value to our members at the lowest possible cost. Reconfiguring our systems and processes to comply with fifty states' varied insurance regulations would be extremely costly and, since we are mutually owned, any increase in expenses would necessarily be passed along to those we insure. Our members would neither understand nor appreciate those increased costs because they know that we already serve them well.

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[7] The American Armed Forces Mutual Aid Association ("AAFMAA") was formed by Army officers in 1879. AAFMAA has a comparable history to ours and, like Navy Mutual, is a non-profit association that sells life insurance to military families.

Navy Mutual's presence in Oregon is small, with fewer than one thousand insureds in the state. However, we respect and value our relationship with Oregon and are, therefore, requesting this legislation to ensure that Navy Mutual's presence in Oregon remains sanctioned by law and fully transparent.

There should be no doubt that Navy Mutual's mission is as vital as ever, particularly at a time when the nation is at war. Please pass SB 781.

Respectfully submitted,

Lauren M. Bloom
General Counsel and Vice President for
Government Affairs

Final Report
Insurance Solicitation Practices on Department of Defense Installations

Presented to:

Deputy Under Secretary of Defense (Program Integration)

May 15, 2000

DEPARTMENT OF DEFENSE

UNITED STATES OF AMERICA

5.0 MUTUAL AID ASSOCIATIONS

5.1 Army and Air Force Mutual Aid Association

This organization is a non-profit, tax-exempt organization formed in January 1879 in the wake of the Custer massacre at Little Big Horn. The primary purpose of the organization is to provide aid to families of deceased members. It expanded in 1984 to include Air Force personnel. The organization provides to members and their spouses personal affairs planning, insurance, pre-retirement, financial awareness counseling and representation when filing death and disability claims. The State of Virginia does not regulate the association as an insurance company, although the association has sold insurance to its members since its inception. Currently the association sells a broad range of life insurance products to its members. At the present time all officers and non-commissioned officers of the Army and the Air Force are eligible for membership. The membership of this organization will vote at the annual meeting in April 2000 to expand membership to all personnel of the Army and the Air Force. All insurance sales are handled by employees of the organization from their offices at Fort Myer, Virginia. Insurance sales are conducted through the mail or by telephone unless a member chooses to visit the Fort Myer office. No commissions are paid on insurance sales, and there is no in-person solicitation conducted on the remainder of the base at Fort Myer or at any other military installation. Association employees and officers provide financial and survivor benefit training to military personnel and their families throughout the DoD.

5.2 Navy Mutual Aid Association

This association was formed in July 1879 as a non-profit tax-exempt voluntary membership organization of sea service personnel and their families. The association is open to all ranks of service members in the Navy, Marine Corps, Coast Guard, Public Health Service and the National Oceanic and Atmospheric Administration. The Virginia State Insurance Commission treats this association as it does the Army-Air Force counterpart. Employees of the association handle all sales from its headquarters at Henderson Hall, Virginia. Sales occur through the mail or by some electronic means of communication, unless a member happens to visit Henderson Hall. The association pays no commissions on insurance sales, and there is no in-person solicitation conducted on the remainder of Henderson Hall or at any other naval or military installation. Historically, this association provided a wider range of insurance product than the Army-Air Force counterpart, but today there are few distinctions between the two in services provided or products offered. The association also provides education on military and naval installations, primarily in the area of Government survivor benefits.

5.3 Analysis

These two associations are truly unique. They were established in the 19th century when Congress declined to provide survivor benefits from public funds. They have their own special provision of the federal tax code. For many years their day-to-day leadership and management were conducted by active duty Army and Navy personnel from Government offices. Today retired officers serve as presidents and chief operating officers of both organizations. Both organizations are located on DoD installations in Arlington, Virginia.

The associations operate from buildings that appear to be part of the installation but are, in fact, built with the associations' funds. To my knowledge, there has never been a breath of scandal about either organization. Neither the Inspector General's teams nor I heard any complaints about these organizations during the conduct of our studies. Unless either of these organizations begins to solicit membership or sales on military installations (there is no indication either organization has plans to do so), these organizations should essentially be ignored in future regulatory efforts. If it is necessary to include these organizations in a revised regulatory structure, care must be taken to respect the historical tradition and service of these associations. They truly are part of the defense establishment.

2D DISTRICT, TENNESSEE

1 RAYBURN HOUSE OFFICE BUILDING
PHONE: (AREA CODE 202) 225-5435

COUNTIES:
BLOUNT
KNOX
LOUDON
McMINN
MONROE
POLK

Congress of the United States
House of Representatives
Washington, D.C. 20515

WAYS AND MEANS

SUBCOMMITTEES:
SELECT REVENUE MEASURES
HEALTH
OVERSIGHT

JOINT COMMITTEE ON TAXATION

7

October 16, 1984

Rear Admiral J. R. Ahern, SC, USN, Ret.
Executive Director
Navy Mutual Aid Association
Navy Department
Washington, D. C. 20370

Dear Admiral Ahern:

In response to your concerns that were recently called to my attention relating to Section 501(c)(23) of the Internal Revenue Code, I would like to assure you that at the time of its enactment this provision was expressly intended to cover both the Army Mutual Aid Association and the Navy Mutual Aid Association.

The Navy Mutual Aid Association has performed a vital service for personnel of the sea services over the years and this was fully understood and appreciated by the members of the Ways and Means Committee and the Committee on Finance in accepting this amendment to the Internal Revenue Code. The intent, underlying the addition of Section 501(c)(23) to the Internal Revenue Code, was to make certain that there could be no doubt whatsoever with respect to the exempt status of the Navy Mutual Aid Association.

Sincerely,

John J. Duncan

JOHN J. DUNCAN
Member of Congress

JJD/pw

Navy Mutual Aid Association

Full Rating Report

Ratings

Security Class	Rating
Insurer Financial Strength	A+

Rating Outlook

Stable

Financial Data

($ Mil.)	2012	2013
Total Adjusted Capital	220	255
Surplus Notes	0	0
Statutory Net Income	24	30
Operating Return on TAC (%)	10.4	8.5
Risk-Based Capital (%)	394	469

Note: Statutory data.
Source: NMAA, Fitch.

Related Research

U.S. Life Insurance Statutory Dividend Capacity (June 2014)

Fitch Affirms Navy Mutual Aid Associations' IFS Rating at 'A+' (March 2014)

North American Life Insurers' Financial Leverage and Debt-Servicing Capacity (March 2014)

2014 Outlook: U.S. Life Insurance (December 2013)

Life Insurers' Investment Portfolios-Results of Fitch's Year-end 2012 Survey (September 2013)

Analysts

R. Andrew Davidson, CFA
+1 312 368-3144
andrew.davidson@fitchratings.com

Julie A. Burke, CPA, CFA
+1 312 368-3158
julie.burke@fitchratings.com

Key Rating Drivers

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

High-Quality, Liquid Investment Portfolio: NMAA's investment portfolio is composed of 36% U.S. government-guaranteed or government-sponsored enterprise debt with very low exposure to structured securities. Portfolio yields have consistently been 6% or above, and realized credit losses compare favorably with the life industry over the 2008–2013 period.

Modest Scale and Narrow Focus: NMAA occupies a modest scale position in the life insurance industry and serves a narrow market. Rating considerations included NMAA's limited access to capital markets and the long-term challenge of membership growth due to its niche customer market. Fitch Ratings also considered the potential for defense department budget cuts that might decrease the size of NMAA's target market weighed against the company's own market building efforts.

Strong Business Profile/Niche: NMAA is a low-cost provider of life insurance protection products to the U.S. Sea Service members and their families. NMAA exhibits a conservative investment and product profile with predictable cash flows. Product liabilities are composed predominantly of term and whole life insurance products with more predictable characteristics and do not have the same volatility of variable annuity products.

Prudently Managed Reserves: Fitch believes that NMAA's "war risk" is prudently managed and that mortality experience is within expectations despite the current military conflicts of the United States of America.

Macroeconomic Uncertainty: Uncertain monetary policy and ongoing discord among government officials pose risks to the economy and credit outlook and could have a material negative effect on NMAA's earnings and capital in a severe, albeit unexpected, scenario.

Rating Sensitivities

Downgrade Triggers: A decline in RBC below 300% of the company action level, a spike in investment-related losses, a trend of sustained net operating losses, increased war risk exposure, or a change in tax or regulatory status could trigger a downgrade.

Upgrade Triggers: Fitch views NMAA at the upper end of its IFS range. NMAA's ratings are based in part on its unique profile as a nonprofit institution serving a narrow customer base. Fitch believes NMAA's strategy, which provides high-value products to its customers and maintains prudent levels of reserves and capital (rather than generating stronger earnings and higher capital levels), limits the upside range of its IFS rating.

Market Position and Size/Scale

- Narrow focus and small scale.
- Stable business profile with defensible niche.
- Membership growth may become more challenging.
- Value-added products/low-cost distribution.

Narrow Focus and Small Scale

NMAA serves a unique customer base of current or former members of the U.S. Sea Services and their families. The company's market and membership (see Appendix A for details) is largely confined by individuals who are either on active duty, reserves, or retired. These three categories make up over three-fourths of its total membership. NMAA also has members who are veterans, but are not yet at retirement age. These limitations constrain the focus and scale of the company compared to many peers in the life insurance industry, a negative factor in Fitch's rating considerations.

However, NMAA possesses several factors and favorable characteristics, which allow Fitch to rate NMAA above the range typical for insurers with similar focus and scale. A mitigating factor is NMAA's strong reputation for integrity and service to its customer base that enhances its value proposition to potential members. NMAA expanded its market in recent years by gaining legislative exemptions in eight states to market to honorably discharged Sea Service veterans without being subject to state insurance regulations. Policies for spouses and children of members have also been an area of growth for NMAA.

Stable Business Profile with a Defensible Niche

NMAA exhibits a stable business profile due to its unique customer base and favorable business mix of traditional life insurance and annuities with conservative features. Fitch considers NMAA to have a secure position in its niche as a provider of insurance to its membership, based on its service quality, efficient operations and exceptionally competitive insurance products. More than 90% of product reserves are for individual life insurance products. NMAA's very competitive crediting rates and low-cost term insurance provides members with value and builds member loyalty.

NMAA exhibits a substantial cost advantage versus many life insurers, as evidenced by its very low, less than 1%, average expense ratio (expense to assets). A number of factors contribute to this low-cost structure, including low overhead, lack of commissioned agents, exemption from state premium tax and insurance regulation. In addition to low expenses, Navy Mutual also benefits from its nonprofit status and a low mortality rate, reflecting the general health of the population segment targeted by NMAA and its medical underwriting process.

Membership Growth May Become More Challenging

Fitch views growth in the number of new NMAA members as one of its long-term challenges. While all four services will see reductions of force in the near future, the Navy is expected to see only modest manpower reductions of a few hundred sailors from current approximately 324,000 sailors. Marine Corps manpower cuts are estimated to be 15,000 by 2017 to 182,000. Under the Pentagon's 2014 budget, military personnel spending will fall to the lowest point since 2008, mainly through cuts to compensation and a decline in the force from its wartime peak.

NMAA has been successful in penetrating its target market, partly based on geographic expansion. Fitch believes that NMAA's increased marketing of its needs-based value proposition, service excellence and education benefits are important tools in reaching more

Related Criteria

Insurance Rating Methodology (November 2013) members. NMAA's membership was approximately 105,500 at year-end 2013. This is a sizable increase after hovering around 100,000 between 2008 and 2012. Slightly less than half are active duty or reservist.

Value-Added Products/Low-Cost Distribution

NMAA serves its defined market with an uncomplicated selection of insurance and annuity product offerings. NMAA's insurance products do not carry coverage restrictions related to war or military service that are often imposed by other insurance carriers. In addition, NMAA is congressionally chartered as a veterans' service organization and provides veterans with information about service-related benefits, such as survivor assistance, educational and other federal benefits.

Corporate Governance and Management

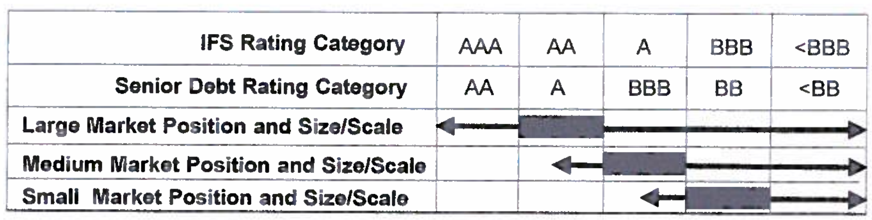
Corporate governance and management are adequate and neutral to the rating.

Johnson Lambert & Co, LLP is NMAA's auditor. The audit opinion for 2013 was unqualified. NMAA reports results under statutory accounting principles.

NMAA currently offers two basic life insurance products: interest-sensitive whole life insurance and term life insurance. Additionally, NMAA 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. NMAA also offers a limited number of fixed annuity products, including 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 channel. New sales are generated through two main sources: direct marketing and member referrals. NMAA's sales are conducted only by salaried employees out of its home office in Arlington, VA.

Ratings Range Based on Market Position and Size/Scale



Ownership Is Neutral to the Rating

NMAA is a mutual aid association formed in 1879 to provide life insurance benefits to its members, who must meet certain criteria to be eligible to join. In NMAA's case the criteria is associated with being a part of the Sea Services. NMAA's ownership structure compares most closely with that of a mutual insurance company.

Fitch believes mutual ownership is a neutral factor at NMAA's rating level. However, Fitch recognizes that relative to the return-focused view of stock ownership, mutual ownership promotes a stronger focus on maintaining financial strength and aligns the interests of managers with those of policyholders. NMAA's nonprofit, federal tax-exempt status also provides an advantage over tax-paying competitors.

Eligible membership currently includes all uniformed personnel of the Navy, Marine Corps, Coast Guard, uniformed officers of the 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 honorably discharged veterans living in certain states.

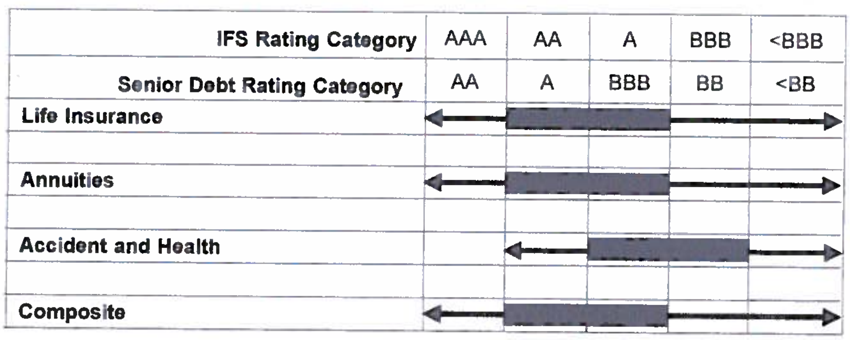
Industry Profile and Operating Environment

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.

Ratings Range Based on Industry Profile/Operating Environment



Peer Analysis

NMAA Compares Well with 'A+' Peers

While small in scale and considered a niche writer, NMAA has solid credit fundamentals and has risk-adjusted capital strength comparable with that of other life insurance companies rated 'A+'. Profitability measures, such as return on total adjusted capital (TAC), are moderately below those of peers, as expected, considering NMAA's high level of distribution of excess earnings to policyholders. Fitch notes NMAA's risky asset ratio is lower than most selected peers. NMAA's main market competitors are selected, similarly rated benefit societies and commercial insurance companies that typically target members of the military. As a result of its low cost structure and mortality experience, NMAA's insurance policy rates and distinctive survivor benefit services compare very favorably with each of these competitors.

Peer Comparison

(As of Dec. 31, 2013)	Insurer Financial Strength	Risk-Based Capital (%)	TAC U.S. ($ Mil.)	Assets/ TAC (x)	Operating Leverage (x)	Risky Assets/ TAC (%)	Financial Leverage Ratio (%)	Pretax Return on Total Assets Post-Dividend (%)	Operating Return on TAC (%)
Navy Mutual	A+	469	255	10.9	9.9	33	0	0.73	8.5
Pan American Life	A	556	267	5.4	4.4	60	8	2.63	13.5
Horace Mann Life Ins.	A	469	403	18.1	12.8	75	20	1.55	12.1
Symetra Financial	A+	461	2,177	12.8	9.5	91	16	0.82	9.6
USAA Life Insurance Co[a]	NR	597	2,113	10.0	9.0	31	3	2.11	12.5

[a]Rating affirmed at 'AAA' and withdrawn June 4, 2014. TAC – Total adjusted capital. NR – Not rated. Note: Financial leverage is for parent holding company.
Source: Fitch Ratings, SNL Financial.

Capitalization and Leverage

	2009	2010	2011	2012	2013	Fitch's Expectation
Total Adjusted Capital ($ Mil.)	200	217	221	220	255	RBC will remain near its current level in 2014. TAC growth in the single digits is expected.
Risk-Based Capital[a] (%)	360	379	399	394	469	
Adjusted Assets/TAC (x)	11.9	11.8	12.1	12.2	10.9	
Financial Leverage Ratio	—	—	—	—	—	

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

Strong Capital, Policyholder Dividend Flexibility

- Stronger risk-adjusted capital.
- Capital flexibility due to whole life book.
- No financial leverage or reliance on capital markets.

Stronger Risk-Adjusted Capital

Fitch views NMAA's estimated National Association of Insurance Commissioners (NAIC) statutory risk-adjusted capital ratio (RBC) as strong. Both TAC and RBC are improving, moving to $255 million and 469% at Dec. 31, 2013 from $220 million and 394% at year-end 2012, respectively. In 2013, TAC increased due to positive operating income, realized and unrealized appreciation on investments.

NMAA carefully monitors and manages its risk-adjusted capital levels, as a mutual aid association that is not subject to state regulation. As such, NMAA is not required to comply with any particular state's insurance regulations.

Key elements of NMAA's capital profile include its large book of predictable participating individual life reserves and its high-quality investment portfolio. Fitch's assessment of capital allows for the inclusion of prepaid home office occupancy costs, which accounts for about 1.5% of NMAA's TAC. Occupancy costs are often permitted by state insurance regulation, but not NAIC statutory accounting practices.

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.

Capital Flexibility Due to Whole Life Book

Fitch believes that management has the flexibility and discipline to adjust whole life excess earnings distributions if necessary to maintain strong levels of capital. For the four-year period ending Dec. 31, 2013, TAC grew at a 6.3% CAGR, despite the high rate of excess earnings paid out to participating policyholders.

No Financial Leverage or Reliance on Capital Markets

NMAA currently employs no financial leverage in its capital structure nor does it have any operating debt, which adds to the quality of its balance sheet and capital. During 2012, NMAA terminated its security lending program. This program was the only debt component of its low total financings commitments (TFC) ratio. That ratio is now zero.

Financial Performance and Earnings

	2009	2010	2011	2012	2013	Fitch's Expectation
Pretax Gain from Operations ($ Mil.)	20	8	4	23	20	For 2014, NMAA will report operating performance similar to 2013, driven by low expenses, solid levels of investment income and low credit-related investment losses. Fitch expects the company will generate high single-digit operating returns on TAC for 2014.
Net Income ($ Mil.)	10	3	16	24	30	
Pretax Return on Total Assets Post-Dividend (%)	0.86	0.32	0.14	0.85	0.73	
Operating Return on TAC (%)	11.0	3.8	1.7	10.4	8.5	
Growth in Revenues (Before Realized Gains) (%)	15	2	3	(3)	0.8	

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

Operating Performance

- Improved operating profitability.
- Consistent earnings drivers with occasional mortality spikes.
- Well-managed and very low expenses.

Improved Operating Profitability

NMAA's operating profitability improved over the past two years and currently is at a level in line with Fitch's median guidelines for the rating category and other peer mutual companies. Still as a mutual entity, NMAA's primary goal is value for its members, not generating a significant statutory profit. As part of its strategy NMAA allocates profits to participating policyholders that are in excess of market averages. As a result profitability is likely to be lower than nonmutual peers. Fitch expects operating returns on TAC of 7%–10% for 2014.

Consistent Earnings Drivers with Occasional Mortality Spikes

Key drivers of NMAA's earnings are its low run-rate mortality, consistent investment income and low expenses. Due to these factors, net gain from operations before realized gains/(losses) has been a steady contributor to net earnings, while some volatility in income has resulted from realized gains/(losses) on investments (bonds in 2012 and common equity in 2011 and 2013).

Generally NMAA's run-rate mortality experience is low due to the better than average health profile of its target market. The exception seems to be occasional mortality spikes due to war casualties. Overall mortality experience continues be within pricing expectations.

Investment income, an important driver of NMAA's earnings, has been strong, with a portfolio yield consistently at 6% or above. Like other life insurers, the company is affected by the lower interest rate environment with pressure on interest margins. The company has taken defensive action with its product crediting rates and investment composition to mitigate the drop in new money yields.

Well-Managed and Very Low Expenses

NMAA consistently manages expenses (expenses to total assets) to a level below the average company in the life industry. Although spending increased in 2013 and 2012 due to systems updates, expanded marketing and increased staffing, NMAA averaged a 0.98% general expense ratio the past two years, which is still low compared with 1.93% for the life insurance industry over the same period. Very low acquisition costs (no commissioned sales force, moderate advertising), no premium taxes and focused target markets drive the low expense levels.

Investments and Asset Risk

	2009	2010	2011	2012	2013	Fitch's Expectations
Cash and Invested Assets ($ Mil.)	2,341	2,499	2,653	2,655	2,746	Navy Mutual will maintain a high-quality investment portfolio. Credit-related investment impairments will be low.
Below Investment-Grade Bonds/TAC (%)	19.0	16.0	16.9	13.5	4.0	
Risky Assets Ratio (%)	71	72	48	48	32	
Investment Yield (%)	6.5	6.3	6.2	6.3	6.2	

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

High-Quality Investment Portfolio Provide Income and Liquidity

- High credit quality.
- Strong investment performance
- Acceptable market risk.

High Credit Quality

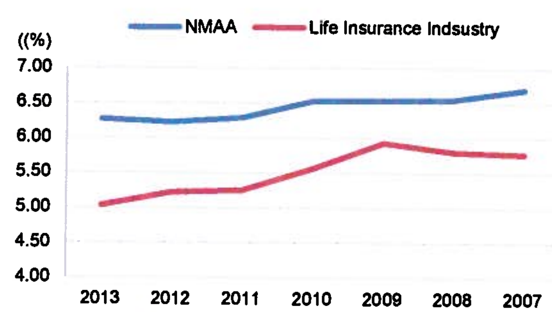
Maintaining a high credit quality fixed-income portfolio is a key strategy for NMAA as seen in its low below investment-grade bonds (BIGs)-to-TAC ratio and risky assets ratio. For year-end 2013, these ratios declined to approximately 4% and 32%, respectively, which is significantly lower than the life industry's exposure to these metrics. NMAA does not buy BIGs as per its investment policy. Below investment-grade bonds were only 1.2% of the bond portfolio at year-end 2013.

NMAA's investment portfolio was 84% bonds at year-end 2013. NMAA has low exposure to commercial mortgages or residential mortgages and no subprime or Alt-A residential securities. NMAA has consistently increased its private placement investment in recent years to 22% at year-end 2013. NMAA limits its aggregate investment in common stocks, direct mortgages and private real estate trusts to 6% of total assets.

Strong Investment Performance

Fitch expects low credit-related losses and continued strong investment income generation in 2014. NMAA investment portfolio generates consistent, strong levels of investment income and has experienced very low credit-related losses over the last five years. Investment income, an important driver of earnings, has been strong, with a portfolio yield consistently at 6% or above. NMAA has performed better than most of the life industry, but expects lower investment yields due to lower reinvestment (new money) yields.in 2014.

Net Investment Yield



Source: Company, Fitch.

Acceptable Market Risk

In the last three years, NMAA decreased its investment allocation to equities reflecting the desire for less capital volatility. At Dec. 31, 2013, common stock investments declined to 2.3% of the investment portfolio. NMAA's long-duration bond portfolio exhibits price risk to a rising interest rate scenario, but has performed well 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. NMAA's bond portfolio typically is of long duration to match the life insurance-dominated liability portfolio.

Asset/Liability and Liquidity Management

	2009	2010	2011	2012	2013	Fitch's Expectations
Liquidity Ratio (%)	97.7	92.1	87.8	85.8	83.5	NMAA's product portfolio is heavily weighted toward life insurance. Fitch expects this to continue.
Operating Cash Flow Coverage (x)	1.9	1.8	1.6	1.5	1.3	
Total Adjusted Liabilities and Deposits ($ Mil.)	2,181	2,355	2,461	2,476	2,525	

Source: Fitch.

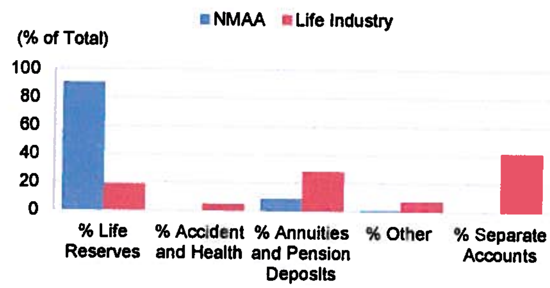
Conservative Products and Good Liquidity

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

Conservative Products

NMAA has a relatively low risk liability profile. NMAA's signature product is its interest-sensitive whole life insurance policy and it has a modest line of annuity products. As of Dec. 31, 2013, life insurance accounts for approximately 90% of the company's $2.5 billion of consolidated general account reserves, while retail annuities account for just 9%. Fitch views the primary product, participating whole life, as relatively low risk, given the long-duration liabilities and limited disintermediation risk.

Adjusted Liabilities and Separate Accounts
(Year End 2013)



Source: NMAA.

NMAA also has not followed the trend of increased product complexity, which requires more sophisticated financial management and increased regulatory and operational risk. It has largely avoided the industry trend towards increasing market-based investment risks and investment guarantees.

Good Liquidity

Fitch considers NMAA's liquidity to be good. The drivers of NMAA's liquidity are the composition of the invested assets and conservative, marketable 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

Fitch considers NMAA's asset liability management to be sound. NMAA conducts cash flow studies under a variety of standard interest rate and equity market scenarios to ensure that its cash-flow matching is sufficient to mitigate any potential disintermediation. Test results from 2013 were favorable even under severe interest rate and equity market scenarios. Both of these products may be under some earnings pressure if interest rates undergo a rapid increase.

Unique Mortality Risk Due to War Catastrophe

NMAA maintains a reserve for war risk and other adverse deviations, which is designed to protect against long-term excess claims due to war and other risks. Fitch believes that NMAA's war risk is being prudently managed and mortality experience is within expectations despite the escalated levels of worldwide conflict in recent years. NMAA estimates that a very low percentage of its in-force membership is currently deployed in areas where war risk is a factor. See the *Reserves* section for more detail.

Reinsurance, Reserves and Catastrophe Risk

Reserve and Risk Mitigation Techniques Are Adequate

- Sound reserving.
- Risk management is adequate.
- New term reinsurance.

Sound Reserving

NMAA's special war risk reserve was voluntarily established to protect against long-term excessive claims due to war or other risks and adverse investment yield scenarios. Fitch views the presence of the reserve as additional conservatism on the company's part and as support for the rating. The reserve was $25.0 million at Dec. 31, 2013 and $25.8 million at year-end 2012.

Fitch believes NMAA's current method for estimating war reserves is reasonable and provides adequate, margin of error for likely events. Since mortality spikes can occur, which utilize the reserve, the lower reserve may cause a more substantial, temporary decrease in profitability while reserves are replenished if the mortality event is large enough.

NMAA reported no increase in reserves for changes in reserving methodology for 2013. In 2011, NMAA also implemented a new, more sophisticated actuarial modeling system for product reserves. Implementing the new model led to a combined $59 million increase in life-related product reserves in 2011 and 2012. NMAA's reported $2.1 billion in life reserves at year-end 2013.

Risk Management Is Adequate

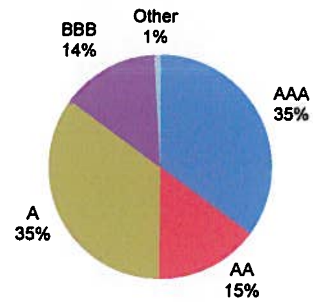
Fitch notes nothing unusual with respect to NMAA's risk management practices relative to industry norms. NMAA continues to manage risk by taking a relatively conservative stance on product risk.

New Term Reinsurance

NMAA entered into a coinsurance treaty with Hannover Life Re covering new level term business effective Jan. 1, 2014. Fitch views the relationship with Hannover to be beneficial with respect to maintaining strong underwriting and risk management techniques for NMAA's book of business.

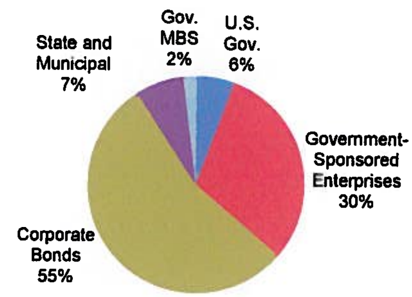
Appendix A: Additional Financial Exhibits

Bond Portfolio by Credit Rating
(Dec. 31, 2013)



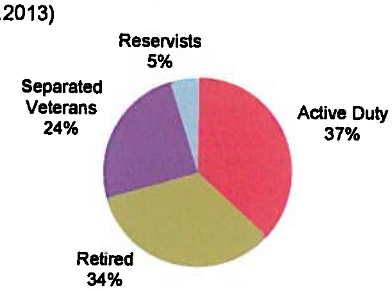
Source: NMAA.

Bond Portfolio by Bond Type
(Dec. 31, 2013)



Source: NMAA.

NMAA Member Profile
(Dec. 31.2013)



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

Operating Performance

($ Mil.)	2013	2012	2011	2010	2009	2008	2007	2006
Total Premium Income	76	75	87	87	89	64	51	52
Investment Income	165	163	158	151	146	139	135	129
Total Revenue	241	239	246	239	236	205	186	181
Gain Before Federal Income Tax and Dividend	20	23	5	40	54	46	44	44
Policyholder Dividend	0	0	2	32	34	33	32	31
Pretax Gain from Operations	20	23	4	8	20	13	12	13
Federal Income Tax	0	0	0	0	0	0	0	0
Net Operating Gain	20	23	4	8	20	13	12	13
Realized Capital Gains	10	1	13	(5)	(10)	(1)	8	1
Net Income	30	24	16	3	10	12	21	14
Total Net Admitted Assets	2,779	2,697	2,681	2,572	2,380	2,230	2,172	2,074
Operating Return on Total Adjusted Capital	8.5	10.4	1.7	3.8	11.0	7.0	6.2	7.4
Pretax Return on Total Assets Predividend	0.74	0.86	0.20	1.62	2.34	2.09	2.07	2.16
Pretax Return on Total Assets Post-Dividend	0.73	0.85	0.14	0.32	0.86	0.59	0.58	0.64
Pretax Operating Margin	8.35	9.55	1.55	3.29	8.40	6.28	6.63	7.18
Expense Ratio	1.14	0.83	0.59	0.51	0.48	0.49	0.42	0.41
Net Investment Yield	6.23	6.26	6.22	6.29	6.53	6.54	6.55	6.60

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

Capitalization

($ Mil.)	2013	2012	2011	2010	2009	2008	2007	2006
Beginning of Period Total Adjusted Capital	220	221	217	200	161	208	192	158
Net Operating Gain	20	23	4	8	20	13	12	13
Net Realized Gain/(Loss)	10	1	13	(5)	(10)	(1)	8	1
Change in Unrealized Gain/(Loss)	6	6	(17)	15	23	(58)	(0)	20
Change in Reserve Valuation	0	(22)	17	(1)	7	0	0	0
Paid in Capital/Surplus	0	0	0	0	0	0	0	0
Dividends to Stockholders	0	0	0	0	0	0	0	0
Other Changes	(1)	(9)	(13)	1	(1)	(1)	(4)	0
Total Changes	34	(0)	4	17	38	(47)	16	34
End of Period Total Adjusted Capital	255	220	221	217	200	161	208	192
Statutory Surplus	231	195	199	191	175	140	179	163
Asset Valuation Reserve	24	25	21	26	25	21	30	28
1/2 Policyholders' Dividends	0	0	0	0	0	0	0	0
Regulatory Capital (Total Adjusted Capital)	255	220	221	217	200	161	208	192
Req. Capital (Company Action Level)	54	56	55	57	55	46	60	58
RBC Ratio (%)	469	394	399	379	360	347	350	332
Asset Leverage (Assets/ Total Adjusted Capital) (x)	10.9	12.2	12.1	11.8	11.9	13.8	10.4	10.8
Operating Leverage (Adjusted Liabilities/Total Adjusted Capital) (x)	9.9	11.2	11.1	10.8	10.9	12.8	9.4	9.8

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

Appendix B: Other Ratings Considerations

Below is a summary of additional ratings considerations of a "technical" nature that are also part of Fitch's ratings criteria.

Notching

The U.S. is a "strong" regulatory environment with restrictions on payments from the regulated insurance entities to holding companies and priority afforded policyholder obligations.

Hybrids — Equity/Debt Treatment

Not applicable.

Recovery Analysis and Recovery Ratings

Not applicable.

Exceptions to Criteria/Ratings Limitations

None.

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.

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