Capital Raise Shows Market Confidence in Manulife Financial

On March 4, 2009, Manulife Financial (the parent company of John Hancock) announced the completion of an offering of 18 million Non-cumulative 5-year Rate Reset Class A shares. With a per share price of $25, the offering resulted in gross proceeds of CDN $450 million for Manulife. The offering enhances Manulife's capital and liquidity position. Completing this transaction in a tight credit market that has made it very difficult for many companies to raise capital, is a clear sign of Manulife's strength.

Rating Actions

Rating agencies are finishing up their year end reviews, which have resulted in one notch downgrades for most carriers. Over the past several weeks, practically the entire life insurance industry, including M Carriers, has experienced a one notch downgrade from all of the rating agencies. The downgrades reflect the weakening of the general economy and its impact on the life insurance industry. Despite rating actions, the insurance industry, including M carriers, still maintains strong financial strength ratings, particularly when compared to other industries (including banking).

Rating actions for M Carriers over the past week are as follows:

Nationwide Financial Services
On March 10, 2009, Moody's downgraded the insurance financial strength rating (IFS) for the key life insurance subsidiaries of Nationwide Financial Services (NFS) to A1 from Aa3 with a negative outlook. The rating action reflects Moody's expectation for significant investment losses, as well as the continuing pressures from the declining equity market on the group's sizable variable annuity business.

Moody's does comment that regulatory capital remains strong, with a consolidated risk-based capital (RBC) ratio in excess of 500% at year-end 2008. In addition, Standard and Poor's has commented that Nationwide has "strong" risk management capabilities. An A1 IFS rating is the fifth best rating out of 19 with a description of "Good."

Pacific Life
On March 6, 2009, A.M. Best downgraded Pacific Life to A+ (Superior) from A++ with a negative outlook. In addition to credit-related losses, Pacific Life's statutory and GAAP earnings were negatively impacted by the equity market downturn through higher required reserves and a negative net mark-to-market loss (FAS 133) on variable annuity guarantees, as well as lower asset-based fee income.

On the positive side, the ratings of Pacific Life reflect its strong risk-adjusted capitalization, extensive distribution relationships, and strong competitive positions.

Pacific Life has maintained its prominent position as a provider of choice in the most affluent market segments for individual life insurance and variable annuities. Furthermore, A.M. Best notes that Pacific Life has not fully utilized available on-shore and off-shore capital management initiatives, which provides the company with more statutory financial flexibility than many of its Superior-rated peers.

Pacific Life also has relatively extensive sources of liquidity. In addition to sizable cash positions and highly liquid assets, Pacific Life is approved to receive collateralized advances as a member of the Federal Home Loan Bank of Topeka (FHLB). As of December 31, 2008, Pacific Life's available capacity for FHLB advances was approximately $1 billion. Pacific Life also has a $700 million commercial paper program; Pacific LifeCorp has remaining capacity under its $500 million revolving credit facility, which matures February 2011.

Neither Pacific Life nor its parent holding company has any long-term debt maturing until 2023. Adjusted financial leverage remains comfortably within the guidelines for the current ratings.

Sun Life
On March 6, 2009, Standard & Poor's downgraded the IFS for Sun Life Financial and its Canadian and U.S. operating subsidiaries to AA from AA+ with a negative outlook. The downgrade reflects deterioration in the global equity market, a subsequent decrease in fee generation from Sun Life's asset management operations, and reserve strengthening for variable annuities with guarantees. Investment portfolios could be susceptible to deterioration from exposure to BBB bonds and commercial mortgages.

Sun Life's liquidity profile remains strong and capital remains robust. An IFS AA rating is the third highest and described as "Very Strong."

A complete summary of M Carrier financial strength ratings can be found at the end of this update.

Closed Block Policyholder Protections

A closed block is formed when a mutual ownership structure is converted to a public ownership company (stock). The closed block is formed to protect the performance of participating policies issued prior to the demutualization. To achieve this protection, assets in the closed block may not be transferred or reallocated to any other portion of the insurer's general account, except under very limited circumstances. To protect dividends, all assets in the closed block must be fully distributed to policies within the closed block. At the time of demutualization, assumptions are made regarding investment results, persistency, mortality, and expenses in order to calculate the amount of funding required for the closed block liabilities. Assumptions are typically based on company experience at time of demutualization, with experience gains and losses reflected in changes to future dividends.

However, policyholders in a closed block should not expect to have more protections from a carrier's insolvency relative to policyholders in other segments of the company's general account. Upon carrier insolvency, the assets in the insolvent company's general account would be allocated by the receiver to the payment of claims in the order of priority established in the insurance liquidation statute of the insurer's state of domicile. Those statutes afford a priority to policyholder claims above general creditors, but do not otherwise prioritize closed block policies above policies funded in other general account segments.

In terms of policy performance, the closed block structure is designed to help provide for the payment of dividends according to the scales in place at the time the block was established, if the experience underlying those scales (including portfolio interest) continues. Thus, while the fact that the company is not free to divert closed block assets does seem to afford some protection, the closed block is not insulated from adverse investment and mortality experience that may occur within the portfolio. Likewise, should closed block assets prove to be insufficient to pay guaranteed benefits, the insurance company would still be liable for the guaranteed coverages in the closed block.

Variable Life Funds Allocated to the Fixed Account and Policyholder Protections

While variable life funds allocated to the separate account are not accessible to general creditors upon carrier insolvency, this is not the case for funds allocated to the fixed account. Funds allocated to the fixed account are actually placed in the general account, which does not have protections from general creditors upon insolvency.

Additionally, while investment grade fixed income strategies are offered in the separate account, they do not enjoy the amortized cost book value accounting for funds sitting in the general account. All separate account assets are marked to market, and have the potential for more volatile returns.

March 12 *Wall Street Journal* Article: "The Next Big Bailout Decision: Insurers"

The *Wall Street Journal* (WSJ) published an article on March 12 regarding the insurance industry. The article does accurately point out some of the challenges facing the industry at this time, including: asset losses on financial securities and residential and commercial mortgaged backed bonds, and increased reserving for variable annuities with guarantees, resulting in some capital and liquidity deterioration and tumbling life insurance stock prices.

As mentioned in previous M communications (including "Insight on the Impact of the Current Financial Crisis—and Existing Safeguards—on the Life Insurance Industry" and the recent M Due Care Bulletin, "Q&A: Carrier Solvency and the Impact on Policyholders"), it is important to distinguish between the interests of stockholders and policyholders. Policyholders are focused on carrier solvency, not share price. The above referenced pieces detail a variety of policyholder protections.

The WSJ article also mentions significant unrealized investment losses for the industry, that due to accounting rules, are not recorded on the bottom line. There is logic supporting these accounting rules. A significant portion of insurer assets are held to maturity in order to support long-term liabilities. The basic idea is this: if an asset is intended to be held to maturity, then you should be protected from interest rate movements and their impact on the market value of the asset. If interest rates go up, then the market value of the fixed income instrument would decrease, and vice versa. But since the asset will be held to maturity, there is no need to mark to market. However, if the credit worthiness of an asset is at stake (i.e., it is uncertain the principle will be repaid) then that asset needs to be evaluated for mark to market accounting.

The WSJ article does have several positive takeaways regarding the life insurance industry:

- There is a general lack of carrier dependence on the capital markets to fund daily operations, which is a sign of strong capitalization and liquidity and is helpful given today's tight credit market.
- Carriers have inforce books of business that generate cash, which enhances the liquidity position.
- Many insurers do not have any sizable debt that matures in 2009, which reduces cash outflow and strengthens their liquidity position.
- Many insurers have built up large cash reserves, again providing liquidity.

In general, the insurance industry continues to have high financial strength ratings supported by good capitalization and liquidity.

Finally, the article addressed the situation with AIG, mentioning that the insurance industry challenges are different from the issues plaguing AIG (losses from derivatives primarily related to credit default swaps). As AIG continues to receive significant media attention, this is an important distinction.

M Financial will continue to monitor and evaluate developments relating to M Carriers and the industry as a whole in an effort to keep Member Firms and their clients informed. If you have any questions or comments, please contact any member of the M Product Management team at 800.656.6960.

M Financial Carriers
Summary of Financial Strength Ratings
(as of March 13, 2009)

	A.M. Best		
M Carrier	FSR	Description	Category
John Hancock	A++	Superior	1st of 15
Lincoln National	A+	Superior	2nd of 15
Nationwide	A+	Superior	2nd of 15
Pacific Life	A+	Superior	2nd of 15
Prudential	A+	Superior	2nd of 15
Sun Life	A+	Superior	2nd of 15
UNUM	A-	Excellent	4th of 15
Genworth	A	Excellent	3rd of 15
ING-Security Life	A+	Superior	2nd of 15
Lincoln Benefit	A+	Superior	2nd of 15

	Standard & Poor's		
M Carrier	FSR	Description	Category
John Hancock	AA+	Very Strong	2nd of 17
Lincoln National	AA-	Excellent	4th of 17
Nationwide	A+	Good	5th of 17
Pacific Life	AA-	Excellent	4th of 17
Prudential	AA-	Very Strong	4th of 17
Sun Life	AA	Very Strong	3rd of 17
UNUM	A-	Good	7th of 17
Genworth	A	Good	6th of 17
ING-Security Life	AA	Very Strong	3rd of 17
Lincoln Benefit	AA-	Excellent	4th of 17

	Moody's		
M Carrier	FSR	Description	Category
John Hancock	Aa1	Excellent	2nd of 19
Lincoln National	Aa3	Excellent	4th of 19
Nationwide	A1	Good	5th of 19
Pacific Life	Aa3	Excellent	4th of 19
Prudential	Aa3	Excellent	4th of 19
Sun Life	Aa3	Excellent	4th of 19
UNUM	Baa1	Adequate	8th of 19
Genworth	A1	Good	5th of 19
ING-Security Life	A1	Good	5th of 19
Lincoln Benefit	A1	Good	5th of 19

	Fitch Ratings		
M Carrier	FSR	Description	Category
John Hancock	AA	Very High	3rd of 18
Lincoln National	AA-	Very High	4th of 18
Nationwide	A+	High	5th of 18
Pacific Life	AA-	Very High	4th of 18
Prudential	A+	High	5th of 18
Sun Life	AA	Very High	3rd of 18
UNUM	A-	High	7th of 18
Genworth	A-	High	7th of 18
ING-Security Life	AA-	Very High	4th of 18
Lincoln Benefit	A	High	6th of 18