



Lincoln Financial Group: Comments from Citigroup

On April 2, 2009, Citigroup analyst Colin Devine issued a report downgrading Lincoln Financial Group (LNC) to 3S (sell, speculative). Note this is a stock valuation downgrade, not an insurance financial strength downgrade. The report cited “an increasingly uncertain financial position and the erosion of [Citigroup’s] confidence in Lincoln’s ability to successfully navigate through what continues to be very challenging equity markets within an overall deteriorating macro-economic climate.”

More specifically, Colin cited key valuation issues, including liquidity, capital adequacy, variable annuity living benefit guarantees, realized investment losses, and statutory XXX and AXXX reserves backing term and universal life. Colin projects that earnings for the first quarter of 2009 will be the worst earnings quarter in Lincoln’s history. The report goes on to state that “while management’s best course of action appears to be an outright sale, we cannot identify any potential buyers for the entire company and see only a limited number of possible candidates for select businesses.”

Despite this news, the report did include comments supporting M Financial Group’s ongoing dialogue regarding the differences between policyholder interests and stockholder interests. As a stock analyst, Colin is focused on the interests of Citigroup clients who own, or are considering the purchase of, Lincoln Financial stock. However, his report did include reassuring comments for Lincoln Financial regarding policyholders:

“[Citigroup has] no reason to believe LNC cannot fully honor all of its policyholder and debt obligations. But, in the unlikely event the holding company filed for bankruptcy it would not mean the life insurance operating subsidiaries would do the same. For example, during Consec’s bankruptcy its insurance subsidiaries continued to freely operate. Similarly, AIG’s continue to operate despite the problems of the parent.”

A discussion of bankruptcy and insolvency involving any M Carrier gives us pause and has escalated our efforts to obtain information from all sources, including discussions with Lincoln Financial’s management team. However, Colin’s comments about Lincoln’s ability to satisfy existing obligations serve as an important reinforcement of the separation between policyholders and stockholders.

M Financial continues to watch developments with M Carriers very closely. To date, we have not made any recommendation regarding the placement of new business. However, this report illustrates the importance for any client considering the purchase of a Lincoln product to be made aware of the current issues related to Lincoln’s financial condition. In this uncertain time, it critical your clients have current information on any carriers they are considering. To reiterate, this comment applies to the placement of new business with Lincoln Financial.

For existing policyholders, we continue to believe, as does Colin, that Lincoln is able to meet its existing obligations. We will continue to assess developments as they relate to policyholders and provide information and analysis in future M Due Care Updates.



Other Developments Involving Lincoln: Withdrawal of TLGP and Liquidity

Concerns from rating agencies and stock analysts regarding Lincoln Financial's short-term liquidity are due, in part, to emerging debt maturities and Lincoln's withdrawal from Temporary Liquidity Guarantee Program (TLGP) funds. Lincoln responded to liquidity concerns with communications released on March 30 and March 31. In addition, a Credit Suisse equity research communication on Lincoln, addressing TLGP and liquidity, was released on March 30. These communications can be accessed in the Members Area of the M Financial website.

On March 27, Lincoln Financial announced that it has voluntarily withdrawn its application from the TLGP offered by the U.S. Government, due to eligibility requirements (intended for banking industry). While Lincoln had applied for TLGP, the company's capital and liquidity plans do not assume receipt of funds from TLGP. However, Lincoln states that it would consider submitting another application if the terms of TLGP are revised to broaden eligibility. Please note that Lincoln has not withdrawn its application for TARP (Troubled Assets Relief Program) funds.

Lincoln's withdrawal of TLGP funds has drawn some concern given Lincoln's near-term liquidity needs of \$500 million debt maturity on April 6 and \$375 million commercial paper maturity in May. Lincoln states that it will be able to meet the near-term debt obligations with internal cash and additional commercial paper financing.

Lincoln is taking the following steps to bolster capital and liquidity:

- \$250M cost reduction program
- \$240M reinsurance transaction
- Virtual elimination of common stock dividend

Lincoln also has the following funding options available if need be:

- Additional securitization
- Additional reinsurance
- Selling of assets
- \$1 billion line of credit
- Internal cash

The Credit Suisse report states that "we ultimately believe Lincoln will be able to maneuver through the current liquidity squeeze," with the following supporting reasons:

- Borrowing up to 25% of statutory surplus (\$900M)
- Dividend from subsidiaries (\$562M)
- Other strategic options: sale of Delaware Investment Management or Group Protections Divisions (\$700M), additional reinsurance transactions, government capital programs, and equity from private investors.



Rating Action: Fitch

Sun Life: On March 23, Fitch Ratings downgraded the insurer financial strength (IFS) ratings of SLF's primary Canadian and American life insurance subsidiaries to 'AA-' from 'AA'. The Rating Outlook is Negative.

The one notch ratings downgrade of the operating companies was driven by the impact on 2008 earnings of significant levels of asset impairments and credit-related losses, and the impact of the severe decline in equity markets on fees, as well as reserves for segregated fund guarantee benefits (net of hedging) and universal life benefits (which were unhedged).

Fitch believes SLF is well-capitalized, with a MCCR for Sun Life Assurance Company of Canada of 232% and an NAIC RBC of 357% for Sun Life Assurance Company of Canada U.S. (Sun Life U.S.).

SLF's ratings strengths include balanced and diversified operations, the very strong Canadian franchise with leading market positions and sustainable distribution capabilities, good U.S. niche positions in individual life and annuities and group insurance, good growth prospects for emerging Asian markets, and relatively stable performance in U.S. mutual funds. Disciplined investment strategies have resulted in very strong liquidity and high asset quality, with lower than average consolidated exposure to below-investment-grade bonds and structured securities and a higher than average allocation to Canadian and U.S. Federal and Provincial bonds at 25% of C\$59.1 billion in total bonds at Dec. 31, 2008. Fitch also believes the company demonstrates the use of an effective risk management process and continues to make progress on enhancing operating efficiencies.

Rating Action: Moody's

Lincoln National: On March 19, Moody's downgraded the insurance financial strength ratings of Lincoln National's insurance subsidiaries one notch to A1 from Aa3. The ratings remain on review for possible further downgrade.

Moody's stated that the downgrade was primarily driven by LNC's reduced financial flexibility, weakened profitability, expected further investment losses, and lower statutory capitalization. In addition, dividend capacity from LNC's operating subsidiaries is expected to be constrained over the next one to two years, given the pressures on regulatory earnings and capital.

The rating agency added that the company's investment losses and lower earnings related to the company's significant exposure to the equity markets through its large block of variable annuities with guarantees are expected to result in continued depressed GAAP and statutory earnings. Although LNC's underlying earnings capacity remains good, earnings from variable annuities and the pension and asset management businesses are all highly sensitive to equity market risk and to the weakening economy.



On a positive note, Moody's pointed out that LNC's regulatory risk-based capital tends to be less sensitive to further declines in the equity markets than are other large variable annuity writers. The A1 financial strength rating by Moody's is described as "Good" and is the fifth best rating out of a total of 19 ratings.

Rating Actions: Standard & Poor's

European Global Multiline Insurers: On March 31, S&P announced that it had completed its review of seven European global multiline insurers (GMIs). As a result of the review, S&P lowered its counterparty credit and insurer financial strength ratings on various operating entities of AEGON N.V. (AEGON), ING Groep N.V. (ING), and Assicurazioni Generali SpA (Generali). The ratings on Allianz SE, AXA, AXA France Vie, and Aviva International Insurance Ltd. were affirmed.

ING Groep N.V. And Subsidiaries (Security Life of Denver): On March 31, S&P downgraded the insurance financial strength ratings of ING Groep insurance subsidiaries, including Security Life of Denver, one notch to AA- from AA, with the outlook remaining negative.

The downgrade reflects S&P's concern of significant pressures on group earnings in 2009 arising from investment-related losses in the insurance division. Bank earnings are expected to be pressured by higher credit losses.

ING is the Netherlands-incorporated, nonoperational holding company of the group, which comprises global banking and insurance operations. Earnings and capital allocation, in S&P's view, are well diversified by segment and geography.

The ratings on ING's core operating subsidiaries reflect S&P's view of its very strong competitive position, high level of diversification, proactive risk management, and strategic focus. The ratings also incorporate S&P's view of the group's significant exposure to investment risk, and a more challenging operating environment.

Rating Action Responses: Moody's

John Hancock: On March 26, John Hancock provided a response to the March 18 Moody's insurance financial strength downgrade of John Hancock to Aa3. The John Hancock response cites diversified earnings base, strong financial flexibility, and well-positioned franchises in North America and Asia. John Hancock also provided supporting documentation (Financial Strength Fact Sheet March 2009 and Investment Fact Sheet March 2009), which is available in the Members Area of the M Financial website.

Prudential: On March 27, Prudential provided a response to the March 18 Moody's insurance financial strength downgrade of Prudential to A2. In summary, Prudential provides facts about its well diversified assets and asset quality (sub-prime asset-backed securities represent only 3% of overall portfolio and 94% of commercial mortgage-backed securities rated AAA), and risk



diversification via global operations. The entire response is available in the Members Area of the M Financial website under the Financial Crisis section.

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

S&P Offers Analysis on Sun Life

On March 23, Standard & Poor's provided an analysis of Sun Life's AA rating, citing the following strengths and weaknesses.

Rating Strengths:

- Top three Canadian life insurance franchise
- U.S. presence provides diversification but would benefit from greater scale
- Well diversified by customer, geography, and product
- Very strong operating earnings and solid capital strength
- Conservative credit risk appetite and reserving practices
- Strong enterprise risk management (ERM)

Rating Weaknesses:

- Holding company's dependence on its operating companies for cash flow
- Weak earnings generated by U.S. annuities business
- Margin compression on fixed annuity product due to low interest rates
- Wealth management businesses are exposed to global equity market volatility

A full analysis of Sun Life by S&P is available upon request from M Financial's Product Management team.

Pacific Life Offers Video Podcasts—Conversations with PL Management

On March 30, Pacific Life announced the following video podcasts:

- CEO Message – Jim Morris
- 2008 Financial Results – Khanh Tran (CFO)
- 2008 Investment Results – Mark Holmlund (CIO)

The video podcasts provide information on PL's 2008 year-end results, investment portfolio, and perspective on the future. Links to the video podcasts are posted to the Members Area of the M Financial website under the Financial Crisis section.

M Financial will continue to monitor and evaluate developments relating to M Carriers and the industry as a whole. 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
(April 3 2009)**

M Carrier	A.M. Best		
	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

M Carrier	Standard & Poor's		
	FSR	Description	Category
John Hancock	AA+	Very Strong	2nd of 21
Lincoln National	AA-	Excellent	4th of 21
Nationwide	A+	Good	5th of 21
Pacific Life	AA-	Excellent	4th of 21
Prudential	AA-	Very Strong	4th of 21
Sun Life	AA	Very Strong	3rd of 21
UNUM	A-	Good	7th of 21
Genworth	A	Good	6th of 21
ING-Security Life	AA-	Excellent	4th of 21
Lincoln Benefit	AA-	Excellent	4th of 21

M Carrier	Moody's		
	FSR	Description	Category
John Hancock	Aa3	Excellent	4th of 21
Lincoln National	A1	Good	5th of 21
Nationwide	A1	Good	5th of 21
Pacific Life	Aa3	Excellent	4th of 21
Prudential	A2	Good	6th of 21
Sun Life	Aa3	Excellent	4th of 21
UNUM	Baa1	Adequate	8th of 21
Genworth	A1	Good	5th of 21
ING-Security Life	A1	Good	5th of 21
Lincoln Benefit	A1	Good	5th of 21

M Carrier	Fitch Ratings		
	FSR	Description	Category
John Hancock	AA	Very High	3rd of 21
Lincoln National	AA-	Very High	4th of 21
Nationwide	A+	High	5th of 21
Pacific Life	AA-	Very High	4th of 21
Prudential	A+	High	5th of 21
Sun Life	AA-	Very High	4th of 21
UNUM	A-	High	7th of 21
Genworth	A-	High	7th of 21
ING-Security Life	AA-	Very High	4th of 21
Lincoln Benefit	A	High	6th of 21