



Actuaries' Section Mid-Year Meeting

*Wyndham Drake
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Fraternal Financial Condition:

The Impact of the 2008 Economic
Hurricane

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A. M. Best Company reports...

- ❑ "2008 was among the worst in memory for life insurers' operating performance..."
- ❑ "These trends are continuing and could deepen well into 2009 and beyond."
- ❑ "...revised outlook on the U.S. life/annuity segment to negative..."
- ❑ "...macroeconomic conditions have continued to deteriorate..."



A. M. Best Company reports...

A. M. Best has observed the following trends:

- ❑ Significant levels of unrealized losses
- ❑ Escalating credit impairments and investment write-downs
- ❑ Deterioration in earnings in core business lines
- ❑ Lower sales in certain product lines

“...expectation that weakness will continue for the foreseeable future”

and others...

JOURNAL OF ACCOUNTANCY

"...once a new cost basis is established from any write-down, any subsequent appreciation in fair value... may not be recognized until the security is sold."

washingtonpost.com

"..the industry is lobbying regulators for permission to keep less money in reserves..."

"...the recession could reduce the value of the bonds they hold... the return they promised is no longer supported by the assets..."

and others...

BROOKINGS

"...the government should require federal solvency and consumer protection regulation of the largest insurers..."



"(guaranty fund contributions)...one failure could lead to a string of failures, each one pushing another company over the brink."





THE WALL STREET JOURNAL.
ONLINE

reports...

- ❑ “Insurers of all sizes are being slammed by investment losses...”
- ❑ “At one insurer, a state receiver has imposed a moratorium on (withdrawals)...”
- ❑ “For Insurers, Survival Itself Is the Big News”
- ❑ “The tumbling financial markets are dragging down the life insurance industry...”
- ❑ Life insurer purchases of bonds were down 63% in the fourth quarter.

Fraternally speaking...

One society was singled out by Best, when they wrote: "...the society's capitalization has weakened considerably" blaming "investment losses" that are "inherent under the current volatile investment markets."

...and for another Best wrote: "...sustained large realized losses. In addition, the company's level of unrealized losses is high relative to its unassigned funds, and further declines in equity market values would continue to negatively impact its surplus funds, which have already declined significantly in 2008."

2008 Fraternal Industry Results

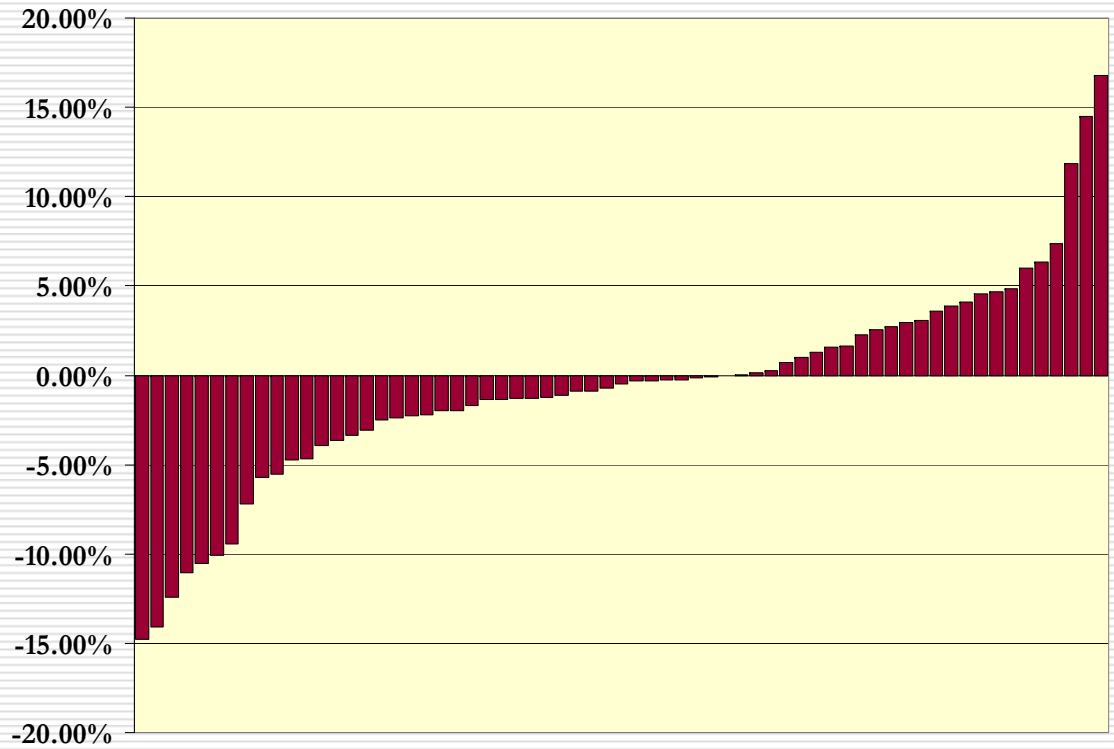
□ The **“UP”** side:

- Total premiums collected were higher in 2008 than in 2007
- The fraternal system as a whole reported a Net Gain from Operations after Refunds

□ The **“DOWN”** side:

- Admitted Assets declined
- Surplus decreased significantly

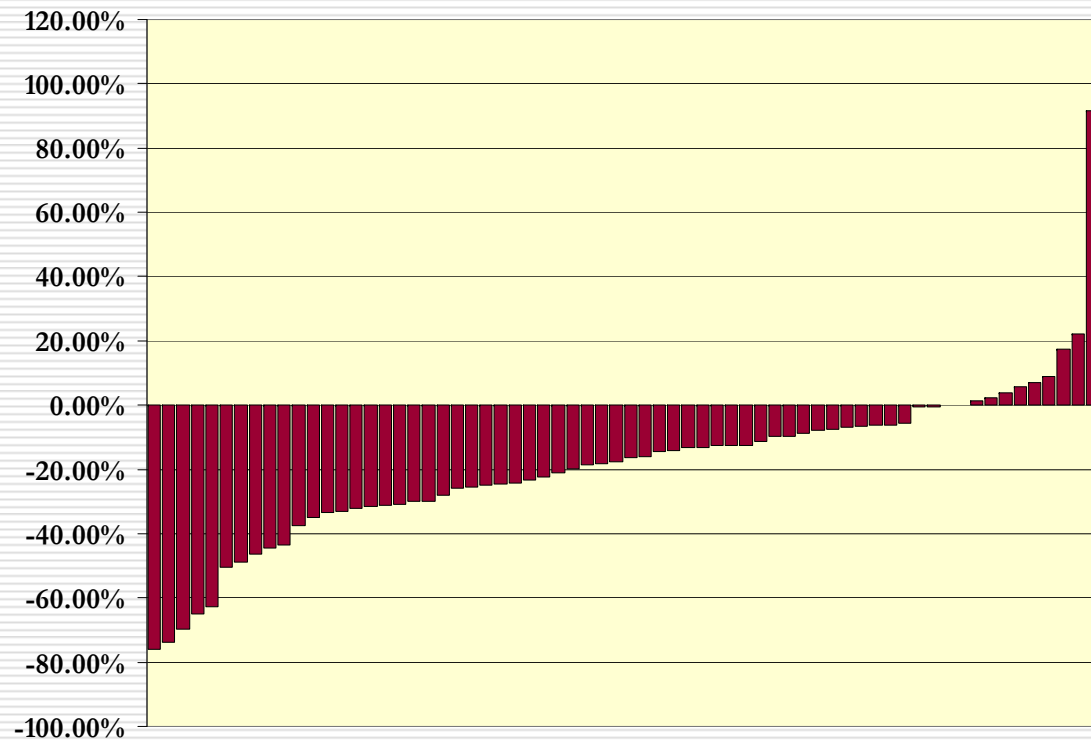
Asset drain?



A net decrease of over **\$156 million** in admitted assets; ranging from a decline of -15% to an increase of +30%

62% of all fraternal societies report lower assets on 12/31/08

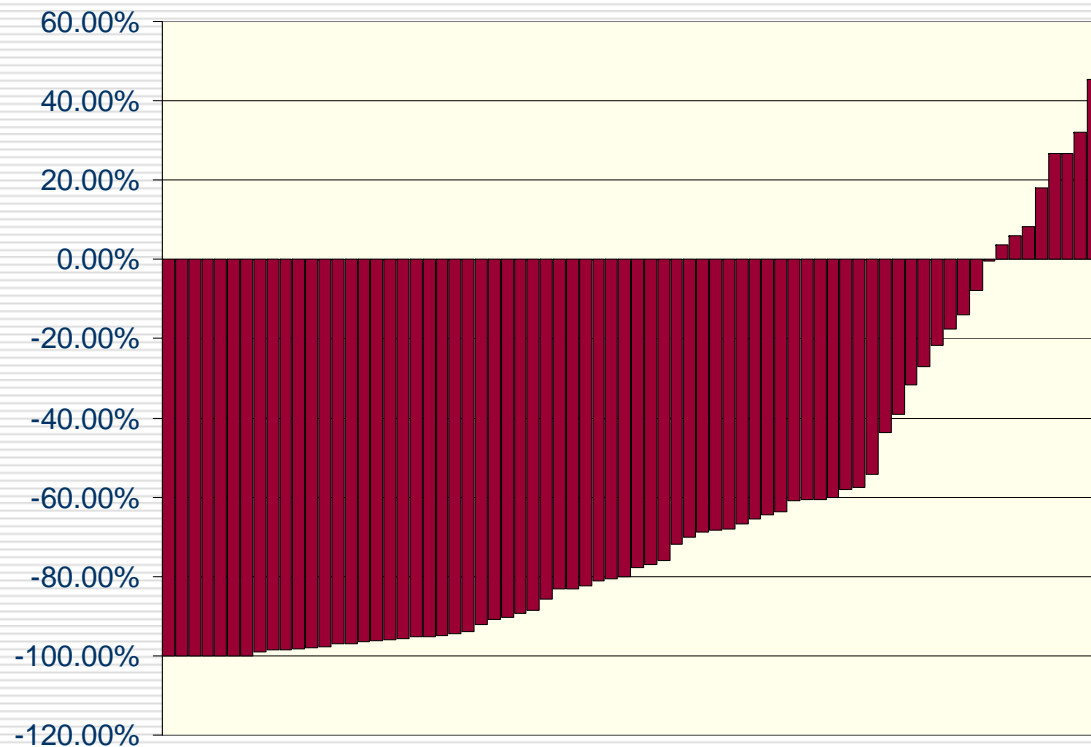
Solvency strain?



83% of all fraternal societies report a decline in surplus for 2008

A loss of almost
\$1.2 billion
in surplus...
ranging from an
increase of 92% to
a decline of -76%
(an industry-wide
decline of 12%)

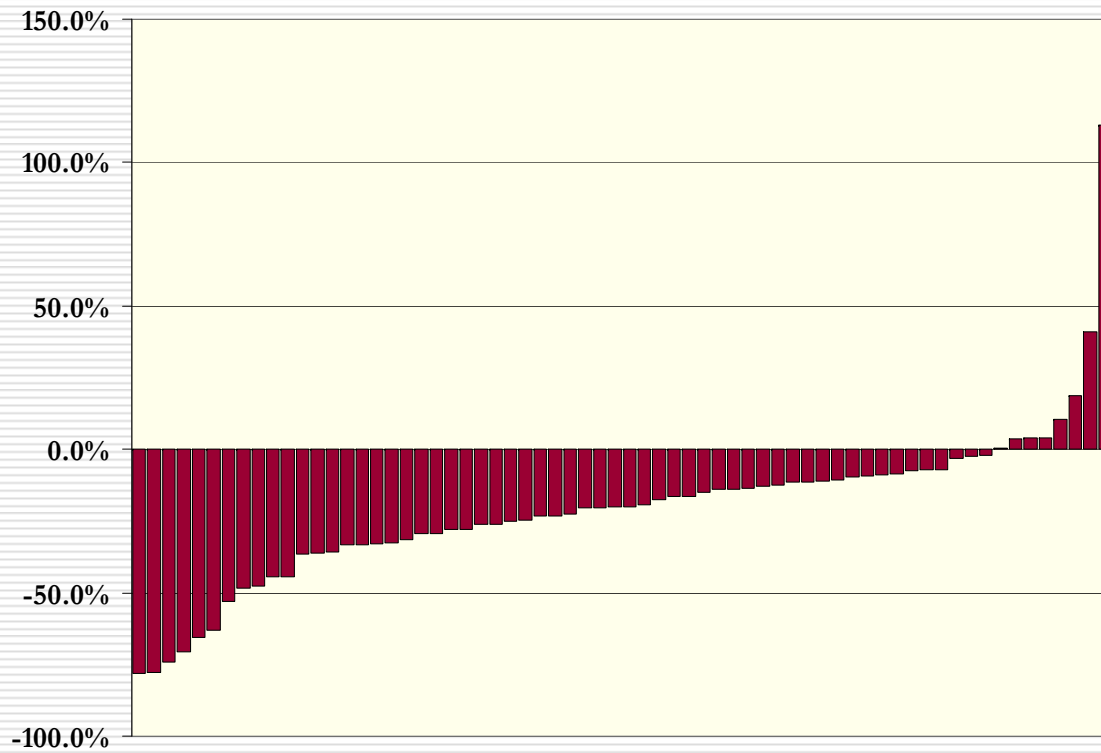
AVR pain?



...and required additions to be made
in 2009

A loss of over
\$889 million
in asset valuation
reserves...
(an industry-wide
decline of 74%)

Assets to Liabilities Ratio



37 societies report a decline in solvency of more than 20% in 2008

Just **8** societies improved their surplus ratio in 2008

Premiums Collected

- **System-wide premiums collected grew by 19%**
 - More than 60% of all societies increased premiums collected in 2008 by more than 10% over 2007
 - Less than 20% of all societies reported declines in premiums collected

Profitability

- ❑ 64% of all societies report 2008 Net Gains from Operations After Refunds
- ❑ For 2/3s of these societies, gains were wiped out by Net Realized Capital Losses
- ❑ In all, just 16 societies report a positive Net Gain for 2008

**System-wide 2008 Net Loss -
(\$480 million)**

“Stressing” for Success?

Can we take another economic storm?

- ❑ Surplus lost: \$1.2 billion
- ❑ AVR lost: \$889 million
- ❑ Market Value below Book Value: **???**

11 Societies entered 2009 with less than \$1 million of surplus (another 4 less than \$2 million)

Risk-Based Capital ("RBC")

Risk-based capital ratio:

Adjusted surplus / 50% Risk-based capital

- ❑ generally, 200% or better – no action
- ❑ 150% - 200% requires a written plan
- ❑ below 150% will bring state action

Risk-Based Capital

- ❑ At least **9** societies reported Adjusted Surplus below 200% of the Authorized Control Level Risk-Based Capital
- ❑ At least **6** more fell within 250% and may be subject to the “trend” test
- ❑ Continued strain from struggling financial markets directly effects RBC
- ❑ Several states have introduced legislation to apply RBC rules to FBS

NFCA Solvency Action Plan

- NFCA Board of Directors recognized the impact of the 2008 economic hurricane
- Four criteria are developed to identify financially troubled societies:
 - Change in Admitted Assets
 - Change in Adjusted Surplus
 - Ratio of Adjusted Surplus to RBC
 - Ratio of Assets to Liabilities (“Solvency Ratio”)

NFCA Solvency Action Plan

Criteria thresholds:

- **-10%** change in admitted assets
- **-40%** change in adjusted surplus
- ratio of adjusted surplus to minimum RBC of **300% or less**
- ratio of assets to liabilities ("solvency ratio") of **103 or less**

NFCA Solvency Action Plan

Action plan classifications:

- **"Grave"** – RBC ratio below 200% or society falling below 4 of 4 thresholds
- **"Critical"** – society falling below 3 of 4 thresholds
- **"Serious"** – society falling below 2 of 4 thresholds
- **"Watch"** – society falling below 1 of 4 thresholds

NFCA Solvency Action Plan

Action to be taken by NFCA:

- **“Grave”** – in-person meeting; corrective action plan; and response team assistance
- **“Critical”** – request in-person meeting; documentation of corrective action; urge use of response team
- **“Serious”** – discussion of concerns and offer of response team
- **“Watch”** – letter of concerns; offer assistance

Fraternal Financial Condition

- ❑ 2008's Economic Hurricane hit us hard
- ❑ We began 2009 in a weakened condition
- ❑ 25 societies fell below NFCA criteria thresholds; 8 societies classified as "grave"
- ❑ We must optimistically explore alternative business models, shared services and mutual assistance



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