ERM Case Study

Introduction and Recommendations

This case study presents information for five companies:

- Lyon Corporation of Canada (a holding company);
- Simple Life (a life insurance company);
- AHA Health (a health insurance company);
- Active Choice (a health insurance company); and
- Pryde P&C (a general, that is, property and casualty, insurance company).

When you register for the ERM exam, you will select from one of six reading extensions. Information presented in this case study will be used in questions appearing on the one-hour extension-specific portion of the ERM exam. Please note that for those who are pursuing an FSA, the extension selected for this exam need not match the track selected for fellowship.

You are encouraged to read this case study before you read the recommended study materials, to become familiar with the information that is provided and to assist you in putting syllabus readings in context.

In any event:

(a) Candidates who elect the Individual Life and Annuities Extension will answer questions based on information about Simple Life;
(b) Candidates who elect the Group and Health Extension will answer questions based on information about AHA Health and Active Choice;
(c) Candidates who elect the General Insurance Extension will answer questions based on information about Pryde P&C;
(d) Candidates who elect the Retirement Benefits Extension will answer questions based on information about the pension plans sponsored by Simple Life and AHA Health;
(e) Candidates who elect the Investment Extension will answer questions based on investment information for Simple Life and about the pension plans sponsored by Simple Life and AHA Health; and
(f) Candidates who elect the General Corporate ERM Extension will answer questions based on information presented for all five companies, except that the questions will be related to general risk management rather than specific requirements related to insurance companies or pension plans.

It is important that you become familiar with the information presented in the case study that pertains to the extension-specific questions you will attempt in the exam.

Exam booklets will contain an exact copy of this case study. You will not be allowed to bring your copy of this case study into the exam room.

The following table of contents should assist you in locating information that is pertinent to your selected extension. As noted above, however, you are encouraged to become familiar with the entire case study.

This and the following pages contain tables for the standard normal distribution. These tables will be available with this case study at the examination and are for use in solving all problems on the examination, including those not related to the case study.

TABLES FOR THE STANDARD NORMAL DISTRIBUTION

Values of z for selected probabilities that $Z \leq z$.

$Pr(Z \leq z)$	0.800	0.850	0.900	0.950	0.975	0.990	0.995
z	0.842	1.036	1.282	1.645	1.960	2.326	2.576

Table for $N(x)$ when $x \geq 0$. Use interpolation with these tables. For example, $N(0.6278) = N(0.62) + 0.78[N(0.63) - N(0.62)] = 0.7324 + 0.78(0.7357 - 0.7324) = 0.7350$.

x	0.00	0.01	0.02	0.03	0.04	0.05	0.06	0.07	0.08	0.09
0.0	0.5000	0.5040	0.5080	0.5120	0.5160	0.5199	0.5239	0.5279	0.5319	0.5359
0.1	0.5398	0.5438	0.5478	0.5517	0.5557	0.5596	0.5636	0.5675	0.5714	0.5753
0.2	0.5793	0.5832	0.5871	0.5910	0.5948	0.5987	0.6026	0.6064	0.6103	0.6141
0.3	0.6179	0.6217	0.6255	0.6293	0.6331	0.6368	0.6406	0.6443	0.6480	0.6517
0.4	0.6554	0.6591	0.6628	0.6664	0.6700	0.6736	0.6772	0.6808	0.6844	0.6879
0.5	0.6915	0.6950	0.6985	0.7019	0.7054	0.7088	0.7123	0.7157	0.7190	0.7224
0.6	0.7257	0.7291	0.7324	0.7357	0.7389	0.7422	0.7454	0.7486	0.7517	0.7549
0.7	0.7580	0.7611	0.7642	0.7673	0.7704	0.7734	0.7764	0.7794	0.7823	0.7852
0.8	0.7881	0.7910	0.7939	0.7967	0.7995	0.8023	0.8051	0.8078	0.8106	0.8133
0.9	0.8159	0.8186	0.8212	0.8238	0.8264	0.8289	0.8315	0.8340	0.8365	0.8389
1.0	0.8413	0.8438	0.8461	0.8485	0.8508	0.8531	0.8554	0.8577	0.8599	0.8621
1.1	0.8643	0.8665	0.8686	0.8708	0.8729	0.8749	0.8770	0.8790	0.8810	0.8830
1.2	0.8849	0.8869	0.8888	0.8907	0.8925	0.8944	0.8962	0.8980	0.8997	0.9015
1.3	0.9032	0.9049	0.9066	0.9082	0.9099	0.9115	0.9131	0.9147	0.9162	0.9177
1.4	0.9192	0.9207	0.9222	0.9236	0.9251	0.9265	0.9279	0.9292	0.9306	0.9319
1.5	0.9332	0.9345	0.9357	0.9370	0.9382	0.9394	0.9406	0.9418	0.9429	0.9441
1.6	0.9452	0.9463	0.9474	0.9484	0.9495	0.9505	0.9515	0.9525	0.9535	0.9545
1.7	0.9554	0.9564	0.9573	0.9582	0.9591	0.9599	0.9608	0.9616	0.9625	0.9633
1.8	0.9641	0.9649	0.9656	0.9664	0.9671	0.9678	0.9686	0.9693	0.9699	0.9706
1.9	0.9713	0.9719	0.9726	0.9732	0.9738	0.9744	0.9750	0.9756	0.9761	0.9767
2.0	0.9772	0.9778	0.9783	0.9788	0.9793	0.9798	0.9803	0.9808	0.9812	0.9817
2.1	0.9821	0.9826	0.9830	0.9834	0.9838	0.9842	0.9846	0.9850	0.9854	0.9857
2.2	0.9861	0.9864	0.9868	0.9871	0.9875	0.9878	0.9881	0.9884	0.9887	0.9890
2.3	0.9893	0.9896	0.9898	0.9901	0.9904	0.9906	0.9909	0.9911	0.9913	0.9916
2.4	0.9918	0.9920	0.9922	0.9925	0.9927	0.9929	0.9931	0.9932	0.9934	0.9936
2.5	0.9938	0.9940	0.9941	0.9943	0.9945	0.9946	0.9948	0.9949	0.9951	0.9952
2.6	0.9953	0.9955	0.9956	0.9957	0.9959	0.9960	0.9961	0.9962	0.9963	0.9964
2.7	0.9965	0.9966	0.9967	0.9968	0.9969	0.9970	0.9971	0.9972	0.9973	0.9974
2.8	0.9974	0.9975	0.9976	0.9977	0.9977	0.9978	0.9979	0.9979	0.9980	0.9981
2.9	0.9981	0.9982	0.9982	0.9983	0.9984	0.9984	0.9985	0.9985	0.9986	0.9986
3.0	0.9987	0.9987	0.9987	0.9988	0.9988	0.9989	0.9989	0.9989	0.9990	0.9990
3.1	0.9990	0.9991	0.9991	0.9991	0.9992	0.9992	0.9992	0.9992	0.9993	0.9993
3.2	0.9993	0.9993	0.9994	0.9994	0.9994	0.9994	0.9994	0.9995	0.9995	0.9995
3.3	0.9995	0.9995	0.9995	0.9996	0.9996	0.9996	0.9996	0.9996	0.9996	0.9997
3.4	0.9997	0.9997	0.9997	0.9997	0.9997	0.9997	0.9997	0.9997	0.9997	0.9998
3.5	0.9998	0.9998	0.9998	0.9998	0.9998	0.9998	0.9998	0.9998	0.9998	0.9998
3.6	0.9998	0.9998	0.9999	0.9999	0.9999	0.9999	0.9999	0.9999	0.9999	0.9999
3.7	0.9999	0.9999	0.9999	0.9999	0.9999	0.9999	0.9999	0.9999	0.9999	0.9999
3.8	0.9999	0.9999	0.9999	0.9999	0.9999	0.9999	0.9999	0.9999	0.9999	0.9999
3.9	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000	1.0000

Table for $N(x)$ when $x \le 0$. Use interpolation (entries are for the row value *minus* the column value). For example, $N(-0.1234) = N(-0.12) - 0.34[N(-0.12) - N(-0.13)] = 0.4522 - 0.34(0.4522 - 0.4483) = 0.4509$.

z	0.00	0.01	0.02	0.03	0.04	0.05	0.06	0.07	0.08	0.09
0.0	0.5000	0.4960	0.4920	0.4880	0.4840	0.4801	0.4761	0.4721	0.4681	0.4641
-0.1	0.4602	0.4562	0.4522	0.4483	0.4443	0.4404	0.4364	0.4325	0.4286	0.4247
-0.2	0.4207	0.4168	0.4129	0.4090	0.4052	0.4013	0.3974	0.3936	0.3897	0.3859
-0.3	0.3821	0.3783	0.3745	0.3707	0.3669	0.3632	0.3594	0.3557	0.3520	0.3483
-0.4	0.3446	0.3409	0.3372	0.3336	0.3300	0.3264	0.3228	0.3192	0.3156	0.3121
-0.5	0.3085	0.3050	0.3015	0.2981	0.2946	0.2912	0.2877	0.2843	0.2810	0.2776
-0.6	0.2743	0.2709	0.2676	0.2643	0.2611	0.2578	0.2546	0.2514	0.2483	0.2451
-0.7	0.2420	0.2389	0.2358	0.2327	0.2296	0.2266	0.2236	0.2206	0.2177	0.2148
-0.8	0.2119	0.2090	0.2061	0.2033	0.2005	0.1977	0.1949	0.1922	0.1894	0.1867
-0.9	0.1841	0.1814	0.1788	0.1762	0.1736	0.1711	0.1685	0.1660	0.1635	0.1611
-1.0	0.1587	0.1562	0.1539	0.1515	0.1492	0.1469	0.1446	0.1423	0.1401	0.1379
-1.1	0.1357	0.1335	0.1314	0.1292	0.1271	0.1251	0.1230	0.1210	0.1190	0.1170
-1.2	0.1151	0.1131	0.1112	0.1093	0.1075	0.1056	0.1038	0.1020	0.1003	0.0985
-1.3	0.0968	0.0951	0.0934	0.0918	0.0901	0.0885	0.0869	0.0853	0.0838	0.0823
-1.4	0.0808	0.0793	0.0778	0.0764	0.0749	0.0735	0.0721	0.0708	0.0694	0.0681
-1.5	0.0668	0.0655	0.0643	0.0630	0.0618	0.0606	0.0594	0.0582	0.0571	0.0559
-1.6	0.0548	0.0537	0.0526	0.0516	0.0505	0.0495	0.0485	0.0475	0.0465	0.0455
-1.7	0.0446	0.0436	0.0427	0.0418	0.0409	0.0401	0.0392	0.0384	0.0375	0.0367
-1.8	0.0359	0.0351	0.0344	0.0336	0.0329	0.0322	0.0314	0.0307	0.0301	0.0294
-1.9	0.0287	0.0281	0.0274	0.0268	0.0262	0.0256	0.0250	0.0244	0.0239	0.0233
-2.0	0.0228	0.0222	0.0217	0.0212	0.0207	0.0202	0.0197	0.0192	0.0188	0.0183
-2.1	0.0179	0.0174	0.0170	0.0166	0.0162	0.0158	0.0154	0.0150	0.0146	0.0143
-2.2	0.0139	0.0136	0.0132	0.0129	0.0125	0.0122	0.0119	0.0116	0.0113	0.0110
-2.3	0.0107	0.0104	0.0102	0.0099	0.0096	0.0094	0.0091	0.0089	0.0087	0.0084
-2.4	0.0082	0.0080	0.0078	0.0075	0.0073	0.0071	0.0069	0.0068	0.0066	0.0064
-2.5	0.0062	0.0060	0.0059	0.0057	0.0055	0.0054	0.0052	0.0051	0.0049	0.0048
-2.6	0.0047	0.0045	0.0044	0.0043	0.0041	0.0040	0.0039	0.0038	0.0037	0.0036
-2.7	0.0035	0.0034	0.0033	0.0032	0.0031	0.0030	0.0029	0.0028	0.0027	0.0026
-2.8	0.0026	0.0025	0.0024	0.0023	0.0023	0.0022	0.0021	0.0021	0.0020	0.0019
-2.9	0.0019	0.0018	0.0018	0.0017	0.0016	0.0016	0.0015	0.0015	0.0014	0.0014
-3.0	0.0013	0.0013	0.0013	0.0012	0.0012	0.0011	0.0011	0.0011	0.0010	0.0010
-3.1	0.0010	0.0009	0.0009	0.0009	0.0008	0.0008	0.0008	0.0008	0.0007	0.0007
-3.2	0.0007	0.0007	0.0006	0.0006	0.0006	0.0006	0.0006	0.0005	0.0005	0.0005
-3.3	0.0005	0.0005	0.0005	0.0004	0.0004	0.0004	0.0004	0.0004	0.0004	0.0003
-3.4	0.0003	0.0003	0.0003	0.0003	0.0003	0.0003	0.0003	0.0003	0.0003	0.0002
-3.5	0.0002	0.0002	0.0002	0.0002	0.0002	0.0002	0.0002	0.0002	0.0002	0.0002
-3.6	0.0002	0.0002	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001
-3.7	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001
-3.8	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001	0.0001
-3.9	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000

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1. Lyon Corporation of Canada

1.1. Overview

Lyon Corporation of Canada (Lyon Corporation) is a diversified public holding company with interests in the financial industries. The holding company is registered in Toronto and undertakes business in USA, Canada and United Kingdom.

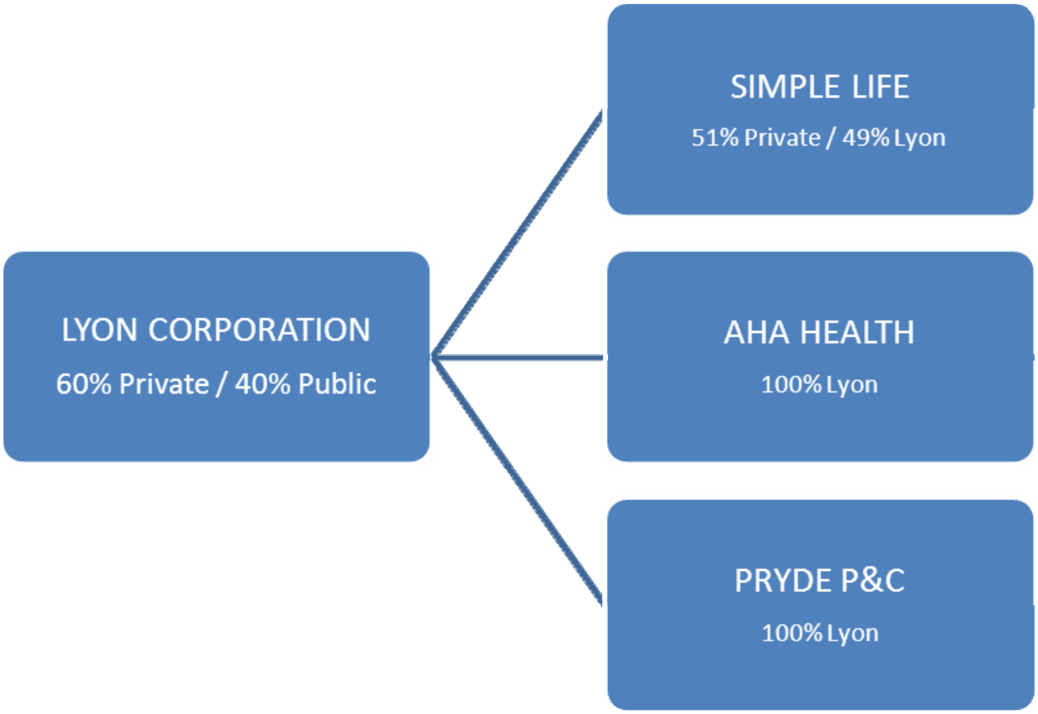
1.2. Mission Statement

Lyon Corporation is committed to enhancing shareholder value through the active management of long-term investments and responsible corporate citizenship. It is of the view that these objectives are best achieved and risks minimized through geographic diversification.

Lyon Corporation believes that the future belongs to corporations having a well-defined strategic vision anchored in strong core values. These principles guide the Corporation in all of its investment decisions.

1.3. Structure

Lyon Corporation is a public company (LCC: NYE and TSX) with a significant shareholder, Lyon Family, which owns about 60% of the outstanding shares. The holding company has the following structure:



Percentages denote equity interest and voting rights.

1.4. Simple Life

The Simple Life Insurance Company is owned by its Chairman, President and CEO, R. Tomas Lyon III, who owns 51% of the voting shares, and Lyon Corporation, which owns 49% of the voting shares. Simple Life is a US life insurance company located in Boston, Massachusetts with four lines of business: Universal Life (UL), Level Premium Term Insurance with three available level term periods: 10, 20 and 30 year, Single Premium Immediate Annuities (SPIA) and Variable Annuities with a Return of Premium (ROP) Guaranteed Minimum Death Benefit (GMDB) and a Guaranteed Minimum Accumulation Benefit (GMAB). Simple Life issues its products only in the US.

Simple Life provides basic life, health and disability benefits to its employees while they are employed by the company. These benefits do not continue after employees leave the company.

Simple Life sponsors a company-paid final-average-earnings defined benefit pension plan for its employees.

1.5. AHA Health

AHA Health Insurance Company (AHA) is a large national insurer located in California with its home office in Los Angeles. AHA is wholly owned by Lyon Corporation. AHA sells individual and group health insurance and has a small block of long term care (LTC) business.

AHA Health provides basic life, health and disability benefits to its employees while they are employed by the company. These benefits do not continue after employees leave the company.

AHA Health sponsors a company-paid final-average-earnings defined benefit pension plan for its employees.

1.6. Pryde P&C

Pryde P&C is an Omaha, Nebraska- based US writer with commercial and personal lines products that target niche market customers. The split between commercial and personal lines is 66.7%/33.3% respectively. Pryde is licensed in all 50 states and its products are sold through a unified sales force, led by sales directors responsible for selecting the product, managing the agency delivery system and serving the business in their territory. Pryde P&C is wholly owned by Lyon Corporation.

Pryde P&C provides basic life, health and disability benefits to its employees while they are employed by the company. These benefits do not continue after employees leave the company.

Pryde P&C does not sponsor any pension or savings plans for its employees.

1.7. Lyon Board of Directors

The Lyon Board consists of 12 members, 4 of whom directly or indirectly represent the Lyon family interest. One of these four also serves as the Board Chairman of SLIC. There are six outside board members, four of whom are Chief Executive Officers or Board Chairmen in leading public companies in the U.S. The other two board members are the Board Chairmen of AHA Health and Pryde P&C.

The following are the directors:

George Bell is the Chief Executive Officer of Rocket Aerospace Inc., the largest manufacturer of civil aircraft in the world.

Sarah Hanrahan is the Chief Executive Officer of Transworld Optics, a leading edge and global company in manufacturing of fiber optics.

Andrew Lyon is the Deputy Chairman of the Board and Co-Chief Executive Officer of Lyon Corporation.

Patrick Lyon is Co-Chief Executive Officer of Lyon Corporation.

R. Tomas Lyon III is Founder and Chairman of the Board of Lyon Corporation, and Chairman of the Executive Committee.

Jeremy Orr is a retired CEO and currently Chairman of Canada Aqua limited, the largest supplier of natural water in the Canadian marketplace.

Albert Montgomery is the Chairman, President and Chief Executive Officer of Northern Oil Sands Limited, one of Canada's largest oil sands company.

John Ritchie is a retired lawyer and a senior advisor to Henderson & Henderson law firm.

Donald Rae is a retired businessperson, formerly CEO and Chairman of Rae Communications, Inc.

R. Tomas Lyon IV has been a director of Lyon Corporation since 1996. He was an insurance broker and President of Risky Life Insurance Company.

Dr. Jerry Graham is the Chairman and CEO of AHA Health.

Robert James is the Chairman and CEO of Pryde Property & Casualty Company.

1.7.1. Mandate of the Board

The mandate of the Board, which it discharges directly or through one of the five Board Committees, is to supervise the management of the business and affairs of the Corporation. Responsibilities include approval of strategic goals and objectives, review of operations, disclosure and communication policies, oversight of financial reporting and other internal controls, corporate governance, Director orientation and education, senior management compensation and oversight, and Director nomination, compensation and assessment.

1.7.2. Executive Committee

The Executive Committee has and may exercise all or any of the powers vested in and exercisable by the Board, except approval of the annual strategic plan.

1.7.3. Audit Committee

The primary mandate of the Audit Committee is to review the financial statements of the Corporation and public disclosure documents containing financial information and to report on such review to the Board, to be satisfied that adequate procedures are in place for the review of the Corporation's public disclosure documents that contain financial information, to oversee the work and review the independence of the external auditors, and to review any evaluation of the Corporation's internal control over financial reporting.

1.7.4. Compensation Committee

The primary mandate of the Compensation Committee is to approve compensation policies and guidelines for employees of the Corporation, to approve compensation arrangements for executives of the Corporation, to recommend to the Board compensation arrangements for the Directors and for the Co-CEOs, to oversee the management of incentive compensation plans and equity compensation plans, and to review succession plans for senior management.

1.7.5. Related Party and Conduct Review Committee

The primary mandate of the Related Party and Conduct Review Committee is to recommend to the Board procedures for the consideration and approval of transactions with related parties of the Corporation and to review and, if deemed appropriate, to approve such transactions.

1.7.6. Governance and Nominating Committee

The primary mandate of the Governance and Nominating Committee is to oversee the Corporation's approach to governance issues, to recommend to the Board corporate governance practices consistent with the Corporation's commitment to high standards of corporate governance, to assess the effectiveness of the Board of Directors, of Committees of the Board and of the Directors, and to recommend to the Board candidates for election as Directors and for appointment to Board Committees.

1.7.7. Summary of Committee Memberships

The following table (where C = chairperson and M = member) summarizes committee memberships for Lyon's Board of Directors:

	Executive	Audit	Compensation	Related Party and Conduct Review	Governance and Nominating
R. Tomas Lyon III	C				C
R. Tomas Lyon IV	M				M
Patrick Lyon	M			C	
Jeremy Orr	M		M		M
John Ritchie	M	M			M
George Bell		C		M	
Sarah Hanrahan		M	M		
Albert Montgomery		M		M	
Andrew Lyon			C		M
Donald Rae			M	M	

1.7.8. Code of Conduct and Business Ethics

The Board of Directors has adopted a Code of Business Conduct and Ethics to promote and maintain a culture of integrity throughout the Corporation. The Code is applicable to Directors, officers and employees of the Corporation.

1.8. Credit Rating

Lyon Corporation has a rating of BBB+. The rating reflects the weakened capital position of Simple Life and recent acquisition failures at AHA Health offset by Pryde's improved financial results and niche presence.

1.9. Oversight of Lyon Companies

Lyon Corporation, Simple Life, AHA Health and Pryde P&C are all managed professionally by an executive team (comprising the CEO, CFO and COO and 4 - 6 other executives). Each CEO reports directly to his respective board. Simple Life, AHA Health and Pryde P&C each have an independent Board of Directors.

The remainder of this document presents information about the companies in which Lyon Corporation has a financial interest.

2. Simple Life Insurance Company (SLIC)

The Simple Life Insurance Company (SLIC) is 51% owned by R. Tomas Lyon III and 49% owned by Lyon Corporation.

SLIC is a life insurance company with four lines of business: Term Life, Universal Life, Single Premium Immediate Annuities, and Variable Annuities.

The Company, founded as Term Life Insurance Company, made its name selling term life insurance, and this continues to be a hallmark of the company today. The Company is at a crossroads where competition has required significant compression of margins. The goal is to capture a portion of the asset build-up within the "baby boomer" generation as its members find that term insurance is insufficient for their needs and wish to change their desired insurance products. To reflect the expanded product offering, the Company was renamed and rebranded as Simple Life Insurance Company at the end of 2009.

2.1. Board of Directors

R. Tomas Lyon III - Chairman, President and CEO

Karl Palomino - former CFO, SLIC

Jeanne Holstein-Palomino - Philanthropist

Ivan X. Salmon - former Chief Legal Counsel, SLIC

Hermione Dauphin - former accounting partner for Dollars 'R Us, former insurance regulator for Insurance Department of Illinois

2.2. Officers

R. Tomas Lyon III, Chairman of the Board, President, CEO

Henri Jay, EVP - Operations

Open, SVP & Chief Financial Officer

Mindy Wren, SVP & Chief Counsel

Odette Bird, SVP - Variable Annuity

George Lyon, SVP - Universal Life

William Xu, SVP - Term Life

Danielle Wolfe - VP - Chief Marketing Officer

2.3. Capitalization

The company operates without any long-term debt. The company strives to maintain a strong statutory risk based capital (RBC) ratio and to have an actual to required economic capital ratio of 125% or greater. Any surplus in excess of the greater of 400% of RBC or 125% of required economic capital is distributed to Lyon Corporation through a dividend annually at the end of the first quarter based on the year-end balance sheet.

2.4. Reinsurance

SLIC utilizes a coinsurance agreement with facultative support with Conservative Reinsurance for its Universal Life Insurance business.

2.5. Investment Policy and Strategy

The investment department manages the general account investments. The Chief Investment Officer (CIO) reports to the CFO. Investment policy and strategy is reviewed and approved by an internal management committee consisting of the CEO, CFO, CIO, and SVPs (or VPs) of its four main business lines. Internal management committee decisions are subject to review by the SLIC Board’s investment committee. The internal management committee meets quarterly and is responsible for reviewing investment results and approving the use of new investment instruments. Day-to-day decision-making authority is delegated to the CIO, up to specified limits. The CIO may delegate approval authority to his or her subordinates. Transactions in excess of the CIO’s approval limit require approval by the CEO and CFO.

The company’s general account is invested primarily in fixed-income assets. Variable annuity investment accounts are held in a separate (segregated) account and are managed by a third-party investment advisor.

Within the general account, there are separate investment portfolios for each of the four main product lines. The corporate surplus (net equity) is allocated to the four portfolios.

2.6. Specified Risk Policies

2.6.1. Credit Risk

Fixed-income securities in the general account have exposure limits at individual obligor (issuer) and sector levels. Obligor-level limits vary according to asset type and credit quality, as determined by external rating agencies. The investment department monitors compliance of the exposure limits.

For each portfolio, there are weighted average credit quality targets. Portfolio credit quality is measured by converting each asset's external credit rating into a numerical score. Scores are a linear function of credit ratings (AAA = 1, AA = 2, etc.). Sub-category ratings (i.e. + or -) are ignored in the scale. The company prefers to maintain a score above 3.5 for each line of business.

2.6.2. Market Risk

Semi-annually within the term, UL and SPIA lines of business, the company measures the Macaulay duration of the assets and liabilities. If the asset and liability durations are further apart than 0.5, the asset portfolio is rebalanced such that its new Macaulay duration equals that of the liabilities.

The VA hedging program uses a dynamic approach updated for market factors monthly and for inforce changes quarterly. The key risk measures are delta and rho, and the program updates its equity and interest rate derivatives such that at least 80% of liability delta and rho are hedged. Vega is self-insured due to system complexity and the expense of implied volatility hedges. Reports are produced and hedges adjusted approximately six-weeks following each quarter end.

The VA liability delta and rho measures are estimated from an actuarial projection model using a home-grown computing platform. Actuarial assumptions are mostly updated annually, and are based on historical experience when possible, and pricing assumptions otherwise. The inforce contract data comes from an extract from the contract administration system, and are subsequently aggregated into modeling cells for computing efficiency. Model access and changes to it are controlled, while its documentation is routinely updated.

A modeling actuary from the valuation group prepares a quarterly report for the hedging group, who then passes along buy and sell instructions to their traders. After completing the transactions, the traders confirm the trades in a report to the hedging group.

2.6.3. Liquidity Risk

The liquidity policy requires SLIC to hold sufficient liquid assets to meet expected demands for cash in a unique liquidity stress-test scenario. The scenario focuses on a reputational liquidity crisis basis where markets continue to operate normally and the liquidity crunch affects only the company. The liquidity stress test anticipates situations where the company's ability to sell assets to meet cash needs from its liability products is hindered by the market taking advantage of the company during the crisis. In addition, testing periodically considers a systemic stress scenario where the entire market is not able to sell assets at a reasonable value. However, SLIC's liquidity policy does not require it to hold sufficient liquid assets to be able to meet cash demands in such a scenario, since it expects regulatory relief in such a systemic crisis.

2.6.4. Operational Risk

The CRO will be responsible for collecting and disseminating risk information. A report will be prepared monthly and distributed to executive management.

2.7. Economic Capital Model

SLIC has implemented an economic capital model tailored to its own company-specific risks. The intent is to quantity the risks to the company's net equity (on a market-consistent basis) using a one-year 99.5% Value at Risk (VaR) measure. The model quantifies exposure to interest rate risk, equity price risk, credit risk, and mortality risk.

Interest rates are modeled stochastically using a single-factor model calibrated to monthly historical data for 10-year US Treasury yields from 1994. Equity returns are modeled stochastically using a regime-switching lognormal distribution that is calibrated to thirty years of daily S&P 500 equity index returns.

For the VA and its GMAB, the VaR is calculated with liabilities net of hedging assets and derivatives. Implied volatility is derived from current exchange-traded 10-year at-the-money equity floors. As an approximation, the test assumes expiring derivatives can be replaced with current at-the-money instruments.

For credit risk, the model assumes that existing investment grade fixed income assets are sold immediately if they fall below investment grade. Therefore, the company does not quantify the risk of credit default or loss given default. Credit risk is modeled through the stochastic simulation of credit ratings migration. The calibration uses ten years of historical data for corporate bond ratings migrations and yield spreads. Since the company has a general buy and hold investment strategy, credit spreads are only considered to be a risk factor if and when investment grade assets are downgraded below investment grade. SLIC calculates the risk of fluctuations in market value due to credit spread movements in the absence of ratings downgrades, but excludes the results since its statutory surplus is based upon asset book value and it has a general buy and hold investment strategy.

The Company is currently considering a few methodologies to capture insurance risk, but has not implemented anything to date. A full-blown stochastic-on-stochastic analysis may be too much of a load on the existing computer infrastructure, so less onerous methodologies are being studied.

At this point, the Company does not have an operational risk model and, therefore, operational risk is estimated to be 10% of the fair value of liabilities, whose calculation excludes any provisions for this risk.

Procedurally, each risk is calculated for each line of business. Each risk is then summed for the company. The risks are then aggregated using a correlation matrix derived from the prior ten years of market movements. All negative correlations are floored at zero. Operational risks are assumed to have zero correlation with other factors.

2.8. Stress Testing

Stochastic testing is supplemented with deterministic scenario-based stress tests, performed annually. Each test is applied as an instantaneous shock to the economic conditions as of the valuation date. Interest rates have a floor of 0.10%.

	Stress A	**Stress B**	**Stress C**
Government Rates			
0.25	+2.00%	-3.00%	-4.00%
0.5	+1.50%	-3.00%	-4.00%
1	+1.00%	-2.00%	-4.00%
5	+0.75%	-1.50%	-2.00%
10	+0.75%	-1.00%	0%
20	+0.50%	-0.75%	0%
30	+0.50%	-0.75%	0%
Corporate Spreads			
AAA	0%	+1.00%	+0.50%
AA	0%	+1.50%	+0.75%
A	0%	+2.00%	+1.00%
BBB	0%	+4.00%	+2.00%
BB	0%	+6.00%	+3.00%
Equity			
Prices	-10%	-30%	+30%
Implied Volatility (10 yr)	+10%	+30%	+10%

2.9. Risk Management Committee

The committee meets on a regular quarterly basis during the year. Meetings focus on reviewing internal risk reports and interviews with key employees in finance, systems, and audit.

At its third quarter meeting, the committee unanimously recommended the hiring of a Chief Risk Officer (CRO), who will create and lead an independent Enterprise Risk Management (ERM) department. The CRO will be responsible for developing and implementing a comprehensive company-wide ERM program and serve as the risk liaison across various business segments to address significant emerging concerns. The committee also recommended that the CRO report on risk-related issues at its quarterly meeting.

However, during the debate of this recommendation with the Board, Mr. Lyon expressed the opinion that the Risk Management Committee would be redundant once the CRO started. His preference was that the CRO report to the EVP-Planning as someone with significant experience who knew the company well and could serve as a guide to the CRO. Mr. Lyon recommended that the new CRO become an officer of the company following three to five years of experience at the company. The Board concurred with Mr. Lyon and the Risk Management Committee will be disbanded on the date the CRO becomes an officer of SLIC.

2.10. Product Distribution:

The Company distributes its product through an independent brokerage system. The Company supplies marketing materials and product descriptions. Brokers are responsible for their own training. The Company has relied upon its distribution system to clarify and explain the change in name of the Company.

2.11. Product Descriptions

2.11.1. Level Premium Term Insurance

The term life insurance product is payable on death up to maturity of the contract. It has guaranteed level premiums and no cash value. Three term periods are available: 10, 20 and 30 year. The product is non-convertible.

Key terms are as follows:

- Face Amount offered from $25,000 to $25,000,000
- Level Premium based upon 150% of expected mortality, an annual lapse rate of 5% and a discount rate of 4%
- Underwriting: simplified issue to all lives with a health questionnaire embedded in the application
- Standard Non-forfeiture Law testing has deemed no necessary cash surrender values

- First year commission equals 100% of premium
- Expected mortality is assumed to be 100% of 2001 US Non-Smoking Ultimate Table

Sales have been extraordinary, in part due to competitive pricing, 100% first year compensation, and a strong advertising campaign. The company's nearest competitor has premiums more than 20% higher and pays sales commission of 35% of premium for the first three years.

The Company is considering reinsurance due to the high volume and high face amounts requested from its clients, but the reinsurance rates from both Conservative Re and from Aggressive Re both make product profitability unacceptable.

Recent mortality experience has been poor but the company has taken steps to reduce anti-selection by terminating the contracts of a few aggressive agents who had been selling policies to people entering hospital for major surgery. Product lapse rates to date have been consistently under 2%.

Since the product is selling well and the Company sees limited downside risk in this plain-vanilla product, the product pricing review will be postponed until 2014.

2.11.2. Variable Annuity

Current Product: Variable Annuity with GMAB

The Variable Annuity with a ROP GMDB has a GMAB rider with a ten-year maturity. It offers a collection of eight proprietary mutual fund choices (seven domestic and one foreign) and a fixed fund invested in the general account. The GMAB rider benefit is to increase the account value to an amount equal to the initial deposit amount at rider maturity, if the account value at the end of 10 years is less than the initial deposit. No deposits are permitted after issue.

Key terms are as follows:

- 2.40% annual fee charged against account balance
    - 1.40% M&E, 1.00% for rider over its coverage period
- 5% of premium one-time first year commission to salesperson
- Surrender charge = (10 - Y)% of account value, where Y = completed years from issue
- Death Benefit = Greater of initial deposit and the account balance (i.e., ROP GMDB)
- At the GMAB rider maturity on the tenth anniversary, the rider benefit is an increase to the account value, if needed, to make the account value at least equal to the initial deposit
- Partial withdrawals are not allowed
- An annual policy lapse rate of 5% is assumed if the account value is greater than the initial deposit less four times the surrender charge; otherwise, no lapses assumed

- Expected mortality is assumed to follow the 2000 Domestic Annuity Table

Sales are significantly lower compared to prior years, probably attributable to other competitors offering a wider range of funds and rider options. To avoid the lengthy and expensive market research and product development cycles, the Company has decided to be a "fast-follower" and copy successful designs it sees in the market place.

Over the prior year, National Bank has begun selling a product to compete with GMAB written by the insurance industry. The product is a rider on an S&P 500 mutual fund that guarantees return of principle for a 2% annual fee applied to the fund value. The rider has no specific death benefit, but has no surrender charges and allows a reset on each anniversary of the deposit. National Bank has numerous branches throughout the country and seems to have a strong marketing department.

Proposed Product Improvements:

First, the marketing team believes that adding a wider range of investment fund options would attract new customers and help to retain existing clients. Therefore, the company plans to add new fund families over the next six months. The new fund options will be available on existing and new VA GMAB contracts as well as on new VA contracts with the new guaranteed benefit riders described below.

Second, Marketing also believes additional guaranteed benefit riders similar to those that competitors have added over the past several years would boost sales. Therefore, the company is considering an enhanced product called VA Plus, adding availability of partial withdrawals, an enhanced Guaranteed Minimum Death Benefit (GMDB) rider, and a Guaranteed Minimum Income Benefit (GMIB) rider. These riders are under development and are expected to be available in nine months.

For GMDB, the death benefit is defined as of the prior anniversary and is the greater of a voluntary annual reset of the fund level and the initial premium accumulated at 5% per annum. The company expects this feature to be affordable since this benefit only pays out upon the rare combination of the insured dying and the market performing below historical average.

For the GMIB, upon contractholder election, the company will use the maximum of account value and a 5% accumulation of initial deposit assumption to buy annuity payments at its current purchase price assumptions.

For both the GMDB and GMIB riders, two alternate withdrawal bases were discussed:

1. Under “dollar-for-dollar,” the benefit is reduced by the amount of the partial withdrawal. For example, adjusted DB = original DB – PW, where DB = death benefit and PW = partial withdrawal.

2. Under “proportional,” the benefit is reduced in proportion to the account value. For example, adjusted DB = original DB * (AV – PW)/AV, where AV is the account value at the time of withdrawal.

Under VA Plus, partial withdrawals will be allowed and handled on a dollar-for-dollar basis.

SLIC will be fast-tracking the product development and implementation process, resulting in a very aggressive time schedule. As part of the implementation process, the administrative system needs additional programming to handle an increased slate of fund and rider offerings.

2.11.3. Universal Life

The universal life product is an adjustable premium product with a level face amount for the life of the contract. The policy will terminate if the account value reaches zero.

Key terms are as follows:

- Face Amount offered from $25,000 to $25,000,000
- Death Benefit = greater of Face Amount and 110% of Account Value
- Target Premium = $25 per thousand payable for 20 years
- Policies only issued to non-smoking males age 40 to 50
- Underwriting is full medical for all contracts
- First year commission equals 50% of the lesser of the target premium and premium paid
- Renewal commissions are 1% of the cumulative premium paid
- Surrender charges for lapses in the first ten years equal to 10% of the lesser of target premium and paid premium in the first two years, grading down to zero in policy year 10
- Partial surrenders are allowed once a year, up to the amount of 25% of cash value
- Cost of Insurance (deducted from account balance annually in advance) = 120% of expected mortality, which is currently 80% of the 2002 US Basic ANB Mortality Table, and is applied to the net amount of risk
- The Cost of Insurance charges are adjustable at the company’s discretion, but only based upon changes in expected mortality. The Cost of Insurance rates shall be changed only on a class basis and with the approval of the regulator, and are subject to prescribed contractual maximum rates.
- A policy maintenance fee of $60 is charged annually, in advance
- Credited rate on the accumulation fund = greater of the underlying portfolio earned rate less a 2% spread and the five year treasury bond yield plus 0.25%, but never less than a

fixed 3%. The credited rate is determined on each policy anniversary and is applicable for the following policy year.

- The company has full discretion in the investment of the policy accumulation funds
- The investment plan used for pricing was a rolling fund of five-year AA corporate paper yielding 6%
- Voluntary policy surrender rate is assumed to be 3.00% per year

Launch sales have been much lower than expected, but the company is anticipating that the 3% floor on investment returns will become more attractive and result in higher future sales. For the UL product, like the VA, the Company has decided that "fast-follower" is the preferred product development method for the near future.

The administrative system needs additional programming to handle some product features that are now available to the client. To date these features selections have been tracked through electronic notes in the policy file.

Three of the Company's competitors in the UL market have recently formed an administrative services only company, called UL Admin Co, to administer their universal life contracts. UL Admin Co performs all of the UL administrative tasks for the three companies, such as policy administration, valuation, and cash flow and reserve projections for planning and risk purposes. In recognition of the expense savings achieved, the three companies have given an extra-contractual benefit to their policyholders by cutting their annual policy maintenance charge by $30.

Conservative Re has agreed to reinsure the mortality risk on a 50% coinsurance basis at the same price as the Company's COI charges with unlimited capacity. Conservative Re is the Company's preferred reinsurance partner as they put no capacity limits on any of their treaties with all of their clients. Conservative Re also provides excellent off-site educational sessions in exotic locations that help meet the Company's employees continuing educational requirements. SLIC considers Conservative Re to be an important strategic partner.

Policy issuance as a percentage of applications has been much lower than expected. Lapse rates in the first year are lower than anticipated in pricing. Recent mortality experience has been approximately equal to expected mortality, but SLIC has little exposure to date.

Due to the current low level of interest rates, the Company has revised the investment plan to be a mix of ten-year BBB corporate debt, high yielding sovereign paper of mixed maturity periods, and some exclusive opportunities in the private equity area.

2.11.4. Single Premium Immediate Annuity

The major product features and pricing characteristics of the only single premium immediate annuity that SLIC has ever sold include:

- Single Premium = 110% of present value of expected payments discounted at 4%
- Straight Life Annuity (no certain period)
- Issued to all ages 65 and over
- No death benefit
- Expected mortality equals 100% of the 2000 US Annuity Table with Projection Scale X
- Commission equals 5% of premium

Recent sales have been slow but have been strengthening recently as interest rates have fallen. Through interviews with select brokers, SLIC has noticed an odd correlation - it seems many of the Company's annuitants have also taken out term life insurance contracts with "We-Serve-the-Healthy" Life in amounts equal to the annuity single premium.

Recent mortality experience has been approximately equal to expected but mortality improvement seems to be higher than expected.

The product is selling well, but decreasing interest rates are a matter of concern. Traditionally, assets supporting this block have been investments in high quality long term corporate bonds and treasuries. However, in response to the recent economic environment and the uptick in expected mortality improvement, higher yielding exotic investments have been utilized recently to help meet the desired 150 basis point profit margin. These new investments include such assets as real estate, domestic private equity and emerging markets common equity

2.12. Balance Sheets

The following are the company's balance sheets ($ million) as of Dec 31, 2011:

Statutory Balance Sheet	SPIA	Term	UL	VA	Total
Cash and Investments (Book Value)	1,810	930	1,840	150	4,730
Deferred Tax Asset	-	-	-	-	-
Separate Account Assets	-	-	-	620	620
Total Assets	**1,810**	**930**	**1,840**	**770**	**5,350**
Best Estimate Liability	*1,640*	*470*	*1,400*	*-20*	*3,490*
Implicit Margin	*-700*	*210*	*270*	*30*	*440*
Statutory Reserve	1,560	680	1,670	10	3,930
Deferred Tax Liability	-	-	-	-	-
Separate Account Liabilities	-	-	-	620	620
Total Liabilities	**1,560**	**680**	**1,670**	**630**	**4,540**
Surplus	250	250	170	140	810
Total Liabilities and Surplus	**1,810**	**930**	**1,840**	**770**	**5,350**
Risk Based Capital	**60**	**60**	**40**	**30**	**170**
Diversification Benefit	-	-	-	-	-20
Actual to Required Capital	417%	417%	425%	467%	476%

Economic Balance Sheet	SPIA	Term	UL	VA	Total
Cash and Investments (Market Value)	1,810	940	1,830	150	4,730
Deferred Tax Asset	50	-	-	-	50
Separate Account Assets	-	-	-	620	620
Total Assets	**1,860**	**940**	**1,830**	**770**	**5,400**
Best Estimate Liability	*1,640*	*470*	*1,400*	*-20*	*3,490*
Explicit Margin	*70*	*70*	*90*	*-*	*230*
Economic Reserve	1,710	540	1,490	-20	3,720
Deferred Tax Liability	-	50	60	10	120
Separate Account Liabilities	-	-	-	620	620
Total Liabilities	**1,710**	**590**	**1,550**	**610**	**4,460**
Equity	150	350	280	160	940
Total Liabilities and Surplus	**1,860**	**940**	**1,830**	**770**	**5,400**
Economic Capital Requirement	**180**	**230**	**100**	**260**	**640**
Diversification Benefit	-	-	-	-	-140
Actual to Required Capital	83%	152%	280%	62%	147%

2.13. Income Statement

The following is the company's income statement ($ millions) for the year ended December 31, 2011:

Statutory Income Statement	SPIA	Term	UL	VA	Total
Direct Premium	167.0	125.0	150.0	50.0	492.0
Ceded Premium	-	-	(12.5)	-	(12.5)
Net Investment Income	89.4	49.8	89.1	7.4	235.7
Net Revenues	**256.4**	**174.8**	**226.6**	**57.4**	**715.2**
Death Benefits (Net of Reinsurance)	-	35.0	25.0	1.0	60.0
Annuity Benefits	98.0	-	-	-	98.0
Surrender Benefits	-	-	33.0	4.0	38.0
Increase in Reserves	123.8	125.0	97.0	5.0	350.8
Commissions	8.4	20.0	20.0	2.5	50.9
General Expenses	1.7	7.5	12.0	6.3	27.5
Taxes, Licenses and Fees	0.8	1.9	3.0	0.3	6.0
Net Transfers to/(from) Separate Account	-	-	-	25.6	25.6
Net Benefits, Expenses and Deductions	**232.7**	**189.4**	**190.0**	**44.7**	**656.8**
Net Gain from Operations	**23.7**	**(14.6)**	**36.6**	**12.7**	**58.4**
Federal Income Tax	7.6	(4.7)	11.7	4.1	18.7
Net Realized Capital Gains (Losses)	(0.2)	(0.6)	(0.3)	(0.1)	(1.2)
Net Income	**15.9**	**(10.5)**	**24.6**	**8.5**	**38.5**

2.14. Portfolio Summary

The following is a breakdown by asset class of the market value of SLIC's general account investment portfolios ($ million), excluding derivatives and variable annuity separate (segregated) accounts.

LOB	U.S. Treasuries	U.S. Agencies	U.S. Mortgage Backed Securities	U.S. Corporate Investment Grade	Short-Term	Other	Total
SPIA	486	492	261	318	72	181	1,810
Term	37	28	9	866	0	0	940
UL	448	462	320	292	125	183	1,830
VA	0	0	0	135	15	0	150
Total	971	982	590	1,611	212	364	4,730

Other asset portfolio characteristics by line of business are as follows:

	Avg Duration	Avg Book Yield	Avg Quality*
Immediate Annuity	8.4	5.34%	2.5
Term	7.0	5.45%	2.7
Universal Life	6.5	5.14%	2.3
Variable Annuity	4.5	5.55%	3.1

**Quality Ratings: Aaa=1, Aa=2, A=3, Baa=4*

2.15. Historical Market Data

In preparation for a review of its economic capital model assumptions, SLIC has compiled the following summary of historical index returns for various asset classes.

Summary of Monthly Index Returns, 3/31/1992 to 3/31/2012

	Barclays Capital U.S. Bond Indices							Equity Indices	
	Treasuries	**Agencies**	**Mortgage Backed Securities**	**Corporate Investment Grade**	**Corporate High Yield**	**Aggregate**	**Long Treasuries**	**S&P 500**	**MSCI EAFE**
Compound Annual Return	6.43%	6.24%	6.47%	7.15%	8.11%	6.63%	8.84%	8.55%	5.92%
Annualized Volatility	4.61%	3.68%	2.84%	5.59%	9.00%	3.73%	9.81%	15.05%	16.88%
Skewness	-0.22	-0.15	-0.06	-0.71	-1.17	-0.28	0.17	-0.69	-0.59
Kurtosis	4.00	4.22	4.89	7.56	12.54	3.93	4.96	4.22	4.29
Correlations									
Treasuries	1.00								
Agencies	0.95	1.00							
Mortgage Backed Securities	0.84	0.89	1.00						
Corporate Investment Grade	0.67	0.76	0.70	1.00					
Corporate High Yield	-0.10	0.05	0.10	0.54	1.00				
Aggregate	0.92	0.96	0.91	0.87	0.22	1.00			
Long Treasuries	0.94	0.86	0.75	0.64	-0.09	0.86	1.00		
S&P 500	-0.15	-0.05	0.02	0.27	0.62	0.06	-0.15	1.00	
MSCI EAFE	-0.18	-0.08	-0.03	0.29	0.62	0.04	-0.17	0.79	1.00
Bond Index Data as of 3/31/2012									
Duration	5.61	3.66	3.32	6.84	4.19	5.01	15.90		
Convexity	0.70	0.01	-2.02	0.91	0.00	-0.16	3.54		
Yield to Maturity	1.19%	1.26%	2.74%	3.41%	7.73%	2.23%	3.11%		
OAS to Treasuries	0.00%	0.36%	0.52%	1.76%	5.76%	0.64%	0.00%		

Source: Barclays Capital, Bloomberg

2.16. SLIC Disaster and Business Continuity Program

Each department within SLIC maintains a Business Continuity Policy (BCP) under the direction and advice of the Business Buoyancy Department (BBD). As part of this process, SLIC senior management has designated business continuity coordinators for each of their respective departments. These coordinators maintain and update business continuity plans, keep inventories of vital records and establish an appropriate record retention schedule. Each quarter, the business continuity coordinators are required to complete a check-box report to senior management to indicate that they have fulfilled their duties.

In addition to complying with the program developed by the BBD, each department is encouraged to institute and maintain a Risk Mitigation Policy (RMP) to help SLIC rebuild in the event of a catastrophe. The RMP includes development and maintenance of rebuild instructions and management succession instructions. The RMP is reviewed and updated on an annual basis.

Periodic disaster recovery exercises are performed where SLIC personnel (with the exception of senior management) are required to work from an offsite location. SLIC has contracted out this offsite service from a third-party, Disasters-R-Us™, that specializes in providing shared disaster recovery capabilities.

Although Disasters-R-Us™ is located a fair distance from SLIC and Disasters-R-Us™ contracts out the same equipment to multiple clients on a first-come, first-serve basis, SLIC senior management felt that the price was affordable.

SLIC also practices each year a fire drill exercise where SLIC personnel (with the exception of senior management) are required to leave the building, meet at nearby pre-determined rallying points and wait for instructions. Those employees with SLIC-issued laptops are required to take their laptops with them, proceed to a nearby coffee shop, purchase a small coffee with the unlimited refill option and continue work by connecting to the coffee shop’s Wi-Fi hotspot.

Each year, SLIC senior management participates in an offsite workshop to review all of the operating policies in the disaster and business continuity program as well as the effectiveness of the most recent disaster recovery and fire drill exercises.

2.17. SLIC Salaried Pension Plan

The following pages contain financial and demographic information about the SLIC Salaried Pension Plan, as well as information about the Statement of Funding Policies and Procedures for the Plan and the Statement of Investment Policies and Procedures for the Plan.

SLIC, through its Board of Directors, has delegated responsibility for the day-to-day management of the Plan to the Vice-President, Human Resources and the Chief Financial Officer. The CFO’s focus is on financial reporting and cash contribution requirements, the VP HR is largely responsible for all other activities.

2.17.1. Pension Plan - Benefit Provisions and Financial Information

The information on the following pages enumerates the current provisions of the Pension Plan and provides certain historical financial information. Historical financial information is not available prior to January 1, 2007.

Extracts of Retirement Benefits Provisions and Financial Information
Simple Life Salaried Pension Plan

Eligibility	Immediate
Vesting	100% after 5 years of plan membership
Normal Retirement Age	65
Early Retirement Age	55 with 5 years of plan membership
Best Average Earnings	Average earnings during 60 consecutive months of highest earnings
Earnings	Base Pay, excluding overtime and bonuses
Normal Retirement Benefit	2% of best average earnings times service years, subject to maximum
Accrued Benefit	Benefit calculated as under the normal retirement benefit formula using best average earnings and service as the valuation date
Early Retirement Benefit	Accrued benefit reduced by 0.25% per month that early retirement precedes age 62 for active participants and actuarial equivalent for terminated vested participants
Form of Benefit	If with spouse, 60% joint & survivor benefit; else single life annuity
Optional Forms of Benefit	None
Indexing	None
Termination Benefit	(1) Lump sum value equal to actuarial present value of accrued pension payable at age 65; or (2) Deferred pension
Pre-Retirement Death Benefit	Lump sum value equal to actuarial present value of accrued pension payable at age 65 to named beneficiary
Disability Benefit	Accrual of service while on long term disability and immediate pension without a reduction upon permanent and total disability

Simple Life Salaried Pension Plan
Historical Actuarial Valuation Results

Participant Summary - January 1

	2007	2008	2009	2010	2011
Active Participants					
(a) count	975	966	959	950	933
(b) average age	50.9	51.2	51.2	51.4	52
(c) average service	17.3	17.5	17.7	17.8	17.8
(d) average future working lifetime	11	11	11	11	11
(e) average plan earnings (prior year)	95,000	95,100	95,200	95,000	94,900
Deferred Vested Participants					
(a) count	-	-	-	-	-
Pensioners (incl beneficiaries)					
(a) count	915	915	916	916	921
(b) average age	74.2	74.2	73.9	73.5	73
(c) average annual benefit	47,500	47,600	47,700	47,700	47,500

Plan Assets (numbers in $000's) *

	2007	2008	2009	2010	2011
Change in Plan Assets during Prior Year:					
Market Value of Assets at January 1 of prior year	-	664,572	679,902	486,055	584,132
Employer Contributions during prior year	-	14,800	16,664	66,946	46,599
Benefit Payments during prior year	-	(44,763)	(44,654)	(45,693)	(45,393)
Expenses during prior year	-	-	-	-	-
Investment return during prior year	-	45,293	(165,856)	76,824	58,886
Market Value of Assets at January 1 of current year	664,572	679,902	486,055	584,132	644,224
Rate of return during prior year	0%	7%	-25%	15%	10.1%
Average Portfolio Mix During Prior Year:					
(a) Domestic Large Cap Equities	0%	40%	39%	33%	36%
(b) Domestic Small Cap Equities	0%	20%	20%	15%	16%
(c) Domestic Fixed Income	0%	30%	30%	42%	39%
(d) International Equities	0%	4%	4%	5%	4%
(e) Real Estate	0%	4%	4%	2%	3%
(f) Cash	0%	2%	2%	3%	2%
(g) Total	0%	100%	100%	100%	100%
Asset Class Returns during Prior Year:					
(a) Domestic Large Cap Equities	0%	5%	-37%	26%	15%
(b) Domestic Small Cap Equities	0%	9%	-45%	28%	5%
(c) Domestic Fixed Income	0%	7%	5%	6%	7%
(d) International Equities	0%	16%	-6%	-17%	13%
(e) Real Estate	0%	6%	-63%	51%	29%
(f) Cash	0%	5%	2%	0%	0%

** numbers may not add due to rounding*

Simple Life Salaried Pension Plan
Historical Actuarial Valuation Results

Actuarial Valuation - January 1 (numbers in $000's) *

	2007	**2008**	**2009**	**2010**	**2011**
1. Actuarial Accrued Liability:					
(a) Active participants	256,032	278,310	279,745	288,114	298,850
(b) Deferred vested participants	-	-	-	-	-
(c) Pensioners	395,509	405,052	406,347	415,085	437,475
(d) Total	651,541	683,362	686,091	703,199	736,325
2. Actuarial Value of Assets	664,572	679,902	486,055	584,132	644,224
3. Unfunded Actuarial Accrued Liability: (1d)-(2)	(13,031)	3,460	200,036	119,067	92,101
4. Normal Cost (beg. Of year)	14,800	15,903	15,805	16,186	16,789
5. Change in Unfunded AAL during prior year:					
(a) Unfunded AAL at prior valuation date	-	(13,031)	3,460	200,036	119,067
(b) Adjustment for Interest	-	(880)	225	13,002	7,739
(c) Normal Cost w/interest less contributions	-	499	(268)	(52,290)	(30,875)
(d) (Gain)/Loss on investment	-	(1,446)	209,140	(44,539)	(20,878)
(e) (Gain)/Loss on salary increases less than expected	-	(17,013)	(17,797)	(18,771)	(19,031)
(f) (Gain)/Loss on assumption changes	-	27,971	0	7,876	30,342
(g) (Gain)/Loss on all other factors	-	7,358	5,276	13,753	5,737
(h) Unfunded AAL at current valuation date	(13,031)	3,460	200,036	119,067	92,101
6. Actuarial Basis					
(a) Interest	6.75%	6.50%	6.50%	6.50%	6.00%
(b) Salary scale	3.75%	4.00%	4.00%	4.00%	3.50%
(c) Consumer Price Index	3.00%	3.00%	3.00%	3.00%	2.50%
(d) Mortality	UP 1994 AA15	UP 1994 AA15	UP 1994 AA15	1994 Uninsured Pensioner Mortality - Generational	1994 Uninsured Pensioner Mortality - Generational
(e) Turnover	None				
(f) Retirement age	Age 62				
(g) Proportion married and age difference	80% married, husbands 3 years older than wives				
(h) Expenses	Assume all expenses paid by company				
(i) Asset Valuation Method	Market value of assets				
(j) Actuarial Cost Method	Projected unit credit				

** numbers may not add due to rounding*

Simple Life Salaried Pension Plan
Historical Actuarial Valuation Results

Expense Valuation - January 1 (numbers in $000's) *	**2007**	**2008**	**2009**	**2010**	**2011**
1. Reconciliation of funded status at valuation date:					
(a) Accrued Benefit Obligation (ABO)	(629,971)	(603,007)	(623,057)	(657,031)	(688,835)
(b) Projected Benefit Obligation (PBO)	(730,433)	(703,251)	(726,773)	(767,023)	(802,888)
(c) Fair Value of Assets	664,572	679,902	486,055	584,132	644,224
(d) Funded Status: (b) + (c)	(65,861)	(23,349)	(240,718)	(182,891)	(158,664)
(e) Unamortized net actuarial gain)/loss	56,088	17,601	241,333	211,784	203,307
(f) Accrued benefit asset/(liability)	(9,773)	(5,748)	616	28,893	44,643
2. Pension Expense:					
(a) Service Cost (beg. of year)	17,759	16,645	17,313	18,558	19,249
(b) Interest Cost	41,734	43,598	43,274	43,866	41,971
(c) Expected return on assets	(48,719)	(49,943)	(37,251)	(43,855)	(45,138)
(d) Amortization of past service cost	-	-	-	-	-
(e) Amortization of net actuarial (gain)/loss	-	-	15,332	12,280	11,183
(f) Pension Expense for year	10,774	10,300	38,669	30,849	27,266
3. Actuarial Basis and Supplemental Data					
(a) Discount rate	5.75%	6.25%	6.00%	5.75%	5.25%
(b) Return on assets	7.50%	7.50%	7.50%	7.50%	7.00%
(c) Salary scale	3.75%	3.50%	3.50%	3.50%	3.00%
(d) Consumer Price Index	3.00%	3.00%	3.00%	2.50%	2.50%
(e) Mortality	UP 1994 AA15	UP 1994 AA15	UP 1994 AA15	1994 Uninsured Pensioner Mortality - Generational	1994 Uninsured Pensioner Mortality - Generational
(f) Turnover			None		
(g) Proportion married and age difference			80% married, husbands 3 years older than wives		
(h) Retirement age			Age 62		
(i) Expenses			Assume all expenses paid by company		
(j) Asset Valuation Method			Market value of assets		
(k) Actuarial Cost Method			Projected unit credit		
(l) Employer contributions	14,800	16,664	66,946	46,599	46,599
(m) Benefit payments	(44,763)	(44,654)	(45,693)	(45,393)	(45,393)

** numbers may not add due to rounding*

Simple Life Salaried Pension Plan

Reconciliation of Plan Participants (2007 - 2011)

	Active	***Pensioners/ Beneficiaries***	***Total***
1. Participants as of January 1, 2007	**975**	**915**	**1,890**
- New Entrants/Rehires	9	-	9
- Terminated Nonvested	(3)	-	(3)
- Terminated Vested (Lump Sum Cashout)	(8)	-	(8)
- Retirement	(7)	7	-
- Death w/ Beneficiary	-	3	3
- Deaths	-	(10)	(10)
- Net change	(9)	-	(9)
2. Participants as of January 1, 2008	**966**	**915**	**1,881**
- New Entrants/Rehires	11	-	11
- Terminated Nonvested	(3)	-	(3)
- Terminated Vested (Lump Sum Cashout)	(7)	-	(7)
- Retirement	(8)	8	-
- Death w/ Beneficiary	-	3	3
- Deaths	-	(10)	(10)
- Net change	(7)	1	(6)
3. Participants as of January 1, 2009	**959**	**916**	**1,875**
- New Entrants/Rehires	9	-	9
- Terminated Nonvested	(3)	-	(3)
- Terminated Vested (Lump Sum Cashout)	(7)	-	(7)
- Retirement	(7)	7	-
- Death w/ Beneficiary	(1)	7	6
- Deaths	-	(14)	(14)
- Net change	(9)	-	(9)
4. Participants as of January 1, 2010	**950**	**916**	**1,866**
- New Entrants/Rehires	4	-	4
- Terminated Nonvested	(2)	-	(2)
- Terminated Vested (Lump Sum Cashout)	(7)	-	(7)
- Retirement	(11)	11	-
- Death w/ Beneficiary	(1)	7	6
- Deaths	-	(13)	(13)
- Net change	(17)	5	(12)
5. Participants as of January 1, 2011	**933**	**921**	**1,854**

Simple Life Salaried Pension Plan
Age/Svc/Earnings as of January 1, 2011

			Service (Years) < 5	5-10	10-15	15-20	>20	Totals
Age (Years)	< 25	# Participants	-	-	-	-	-	-
		Average Salary	-	-	-	-	-	-
	25-35	# Participants	7	45	-	-	-	52
		Average Salary	58,800	66,600	-	-	-	65,600
	35-45	# Participants	22	14	43	54	-	133
		Average Salary	59,500	82,900	87,700	95,400	-	85,700
	45-55	# Participants	4	20	48	149	148	369
		Average Salary	60,500	81,600	90,100	94,500	94,500	92,900
	55-65	# Participants	10	19	58	129	113	329
		Average Salary	55,000	80,200	85,100	92,400	130,600	102,400
	> 65	# Participants	6	10	6	14	14	50
		Average Salary	72,600	91,900	111,200	121,000	149,900	116,300
	Totals	# Participants	49	108	155	346	275	933
		Average Salary	60,200	76,200	88,400	94,900	112,200	95,000

Avg Age	52.0
Avg Svc	17.8
Avg Salary	94,900

Simple Life Salaried Pension Plan			
Interest Sensitivity and Cash Flows			
Rate	**Actives Liabilitiy**	**Pensioners Liabilitiy**	**Total Liabilitiy**
6.00%	298,849,923	437,475,000	736,324,923
5.50%	319,436,841	455,140,469	774,577,310
6.50%	280,175,145	420,993,205	701,168,350
Duration (5.5%)	13.1	7.8	10.0
Convexity (5.5%)	255.9	108.2	168.2
Five Years Ending Dec 31	**Actives Cash Flow**	**Pensioners Cash Flow**	**Total Cash Flow**
2017	55,930,427	200,566,677	256,497,104
2022	110,010,522	181,480,351	291,490,873
2027	134,057,420	151,888,965	285,946,385
2032	130,404,137	113,612,879	244,017,016
2037	118,132,501	71,987,503	190,120,004
2042	96,147,700	35,985,415	132,133,115
2047	66,944,859	13,308,120	80,252,979
2052	39,938,564	3,396,522	43,335,086
2057	20,656,666	537,413	21,194,079
2062	9,219,194	49,492	9,268,686
2067	3,364,241	2,365	3,366,606
2072	873,435	68	873,503
2077	124,446	0	124,446
2082	7,911	0	7,911
2087	132	0	132
2092	0	0	0

2.17.2. Statement of Funding Policies and Procedures - Simple Life

The Company has prepared a Statement of Funding Policies and Procedures ("Statement") to document the governance of the Plan. The Company has also prepared a Statement of Investment Policies and Procedures. Extracts of the Statement are provided below followed by a summary of the Statement contents.

2.17.2.1. Allocation of Responsibilities

The Company has delegated the management of Plan funding as follows:

The Company, acting through Management, will:

- Establish, review and amend, as required, the Statement of Funding Policies and Procedures;
- Select the Pension Consultant and the Actuary;
- Review funding reports prepared by the Actuary regarding the funding of the Plan; and

- Be responsible for the assumption or delegation of any responsibilities not specifically mentioned.

The Pension Consultant and Actuary will:
- Assist, as required, the Company in the preparation of the Statement of Funding Policies and Procedures;
- Present to the Company, as required by the Statement of Funding Policies and Procedures, reviews and reports regarding the funding of the Plan; and
- Comment to the Company on any changes in plan design, contribution flow or pension legislation that may affect the funding of the Plan.

2.17.2.2. Funding Policy Principles

The Company is the primary risk bearer under the Plan. As a result, the funding objective of the Company is the accumulation of assets which will secure the Plan's benefits in respect of service already rendered. The accumulation of assets should be reasonable, without significant volatility or further recourse to the Company's assets.

The Company believes management of the Plan on a going concern basis is the most suitable means to achieve these objectives.

2.17.2.3. Management of Risks

The Company has adopted the following policies to mitigate their risks:

- Going-concern valuations are to be prepared using best estimate assumptions adjusted to include margins for adverse deviation. The Company will consult with the Pension Consultant and Actuary regarding the adoption of margins for adverse deviation.
- Emerging experience will differ from the assumptions made for going-concern purposes. The Pension Consultant and Actuary will monitor emerging experience and recommend revisions to the going-concern assumptions as appropriate.
- Plan provisions are managed to mitigate, to the extent possible, demographic and economic risks. Benefit improvements under the Plan will be made with due regard to the Plan's funded status.
- Investment activity will be carried out with due regard to the liability structure of the Fund, to the cash flow requirements of the Fund, and to the risks and rewards inherent in the defined benefit investments. The Statement of Investment Policies and Procedures documents the Company's policies regarding investment risk.

2.17.2.4. Funding Target

The funding target for the Plan is to have a funded ratio (assets divided by liabilities) of 100% on a going-concern basis.

2.17.2.5. Funding Risks

The Company bears the following funding risks:

- The Plan's demographic experience may differ from best-estimate assumptions. The Plan provides for subsidized early retirement provision and bears the risk of overutilization of the provision by the Plan membership.
- The Plan's economic experience may differ from best-estimate assumptions. In addition to investment risks, the Company bears the risks associated with providing a final average earnings benefit.
- The Plan's liabilities are debt-like in nature and have a long term to maturity. As a result of the current investment strategy and nature of the Plan's liabilities, there is the risk of an asset-liability mismatch.

* * * * * * * *

The contents of the Statement follow:

- PURPOSE
- BACKGROUND, PLAN TYPE AND LIABILITIES
- ALLOCATION OF RESPONSIBILITIES
- FUNDING POLICY PRINCIPLES
- FUNDING RISKS
- MANAGEMENT OF RISKS
- FUNDING TARGET
- ELIMINATION OF DEFICITS
- UTILIZATION OF EXCESSES
- FREQUENCY OF VALUATIONS
- COMMUNICATION
- APPENDIX 1 – Summary of Roles
- APPENDIX 2 – Summary of Liabilities, Assets and Membership Data
- APPENDIX 3 – History of SFP&P Review and Amendments

2.17.2.6. Statement of Investment Policies and Procedures - Excerpts

Following are excerpts from the Statement of Investment Policies and Procedures for the Simple Life Insurance Company's Pension Plan.

2.17.2.7. Investment Risk

- Investment risk is borne by the Company
- Going-concern surplus, subject to any legislative restrictions, can be applied against the Company's Normal Actuarial Cost

2.17.2.8. Allocation of Responsibilities

The Company, acting through Management, will:

- Establish, review and amend, as required, the Statement of Investment Policies and Procedures;
- Select one or more fund managers ("Fund Managers"), the Pension Consultant and the Actuary;
- Select the Custodian to hold pension fund assets;
- Review the performance of the Fund and the Fund Managers at least annually; and
- Be responsible for the assumption or delegation of any responsibilities not specifically mentioned.

The Fund Managers will:

- Manage the asset mix and select securities within each Investment Fund Option, subject to applicable legislation and the constraints set out in this Statement.

The Pension Consultant and Actuary will:

- Assist, as required, the Company in the preparation of the Statement of Investment Policies and Procedures; and
- Comment to the Company on any changes in plan design or contribution flow that may affect the investment of assets.

The Custodian will:

- Fulfil the regular duties required by law of the Custodian in accordance with the Plan;
- Participate in annual reviews of the Statement of Investment Policies and Procedures;
- Present to the Company, at least annually, reviews and reports of investment performance of the Fund Managers;
- Provide the Company with monthly updates on the performance of the Fund Managers;
- Provide the Company with information, on an ongoing basis, about changes at the Fund Managers that could affect investment performance;
- Present to the Company, at least annually, reviews and reports of all investment Fund assets and transactions for the period;
- Monitor actual investments as appropriate to ensure compliance with the Pension Benefits Act; and

- Rebalance the Plan portfolios as requested by the Company.

2.17.2.9. Investment Objectives

- to preserve the capital;
- to provide sufficient funds to meet payments as they become due; and
- to maintain sufficient assets over actuarial requirements to meet unforeseen liabilities.

2.17.2.10. Rate of Return Objectives

(a) to achieve an average annual rate of return, net of investment expenses, of at least the funding valuation rate of return (currently 6.0%) per year, measured over moving, four-year periods;
(b) to achieve top third performance, relative to the peer group of fund managers, measured over moving, four-year periods;
(c) to exceed the passive benchmark for the Pension Fund by 1.00% per annum, measured on a four-year moving average basis; and
(d) to achieve at least the increase in the Consumer Price Index plus 3%, on a four-year moving average basis.

2.17.2.11. Asset Allocation Guidelines

The following normal policy allocation, and associated range for strategic deviation at any time, has been adopted by the Company:

Percentages of Fund at Market Value	**Normal**	**Minimum**	**Maximum**
Domestic Equities	40%	30%	50%
International Equities	20%	15%	25%
Domestic Fixed Income	30%	15%	45%
Real Estate (Private)	4%	0%	8%
Private Equity	4%	0%	8%
Cash	2%	0%	4%

Within the ranges noted above, the Fund Managers may actively vary the asset mix in an effort to achieve the investment objectives of the Company.

2.17.2.12. Passive Management Objectives

The rate of return expected to be achieved through passive management of the assets in the Plan Fund will be based on the normal allocation of assets. The passive return shall be set equal to the sum of:

(a) 45.0% of the S&P 500 Index return for the year;
(b) 20.0% of the MSCI EAFE Index return for the year; and
(c) 35.0% of the Barclays Capital Aggregate Bond Index return for the year.

2.17.2.13. Rebalancing

The Company will direct the re-balancing of the assets in the component pooled funds, when it deems rebalancing to be appropriate.

2.17.2.14. Related Party Transactions

A “Related Party” is:

(a) the Company, acting as Plan Administrator,
(b) an officer, director or employee of the Company,
(c) the funding agent or person responsible for investing the assets of the Plan, or any officer, director or employee thereof,
(d) an association or trade union representing employees of the Company, or an officer or employee thereof,
(e) an employer who participates in the Plan, or an employee, officer or director thereof,
(f) the Plan Participant,
(g) a person (including spouse or child) directly or indirectly holding more than 10% of the voting shares of the Company,
(h) the spouse or child of (a) to (g),
(i) an affiliate of the Company,
(j) a corporation directly or indirectly controlled by a person in (a) to (h),
(k) an entity in which a person in (a), (b), (e) or (g), has a substantial investment (where “substantial investment” means more than 25% of the ownership interests in an unincorporated entity, more than 10% of the voting rights of a corporation or more than 25% of the shareholders’ equity in a corporation) or,
(l) an entity with substantial investment in the Company.

“Related Parties” excludes government or a financial institution holding Plan assets if not the administrator.

The Company, acting as Plan Administrator, shall not, directly or indirectly:

(a) lend the assets of the Plan to a Related Party or invest those assets in the securities of a Related Party; or
(b) enter into a transaction with a Related Party on behalf of the Plan, subject to a minimum limit of $50,000 per transaction and a cumulative limit of $250,000 in a Plan's fiscal year.

Related Party transactions are acceptable provided they are necessary for the operation of the Plan and are purchased on terms and conditions that are at least as favourable for the Plan as are otherwise available.

2.17.2.15. Appendix - Economic Data

The investment consultant for SLIC's DB Plan has supplied the following economic data:

SLIC DB Plan	Market Value ($000)	Duration	KRD 1 Yr	KRD 3 Yr	KRD 5 yr	KRD 10 Yr	KRD 20 Yr	KRD 30 Yr
Plan Actives	298,850	13.1	0.05	0.25	1.08	3.60	4.50	3.62
Plan Pensioners	437,475	7.8	0.20	0.52	1.35	2.85	2.22	0.66
Plan Total Liabilities	736,325	10.0	0.15	0.42	1.25	3.16	3.15	1.87

	Equity Indices		**Barclay's Capital U.S. Bond Indices**	
	S&P 500	**MSCI EAFE**	**Aggregate**	**Aggregate 10+ Year Maturity**
Expected Returns	6.50%	8.00%	2.30%	3.00%
Annualized Volatility	15.05%	16.88%	3.73%	10.02%
Duration	0.00	0.00	5.01	14.19
Skewness	-0.67	-0.77	-0.41	0.03
Kurtosis	4.22	4.51	4.82	5.56

	Equity Indices		**Barclay's Capital U.S. Bond Indices**	
Correlations	**S&P 500**	**MSCI EAFE**	**Aggregate**	**Aggregate 10+ Year Maturity**
S&P 500	1.00			
MSCI EAFE	0.79	1.00		
Aggregate	0.06	0.04	1.00	
Aggregate 10+ Year Maturity	-0.10	-0.05	0.90	1.00

SLIC DB PLAN: Top 10 Equity Holdings

Rank	Name	Beta	Rank	Name	Beta
1	General Electric	1.60	6	Caterpillar	2.00
2	Citigroup	0.99	7	Berkshire Hathaway	0.48
3	Exxon Mobil	0.49	8	Costco	0.79
4	Mead Johnson	0.75	9	Procter & Gamble	0.46
5	AT&T	0.60	10	Cisco Systems	1.18

SLIC DB Plan:

Portfolio Managers US Fixed Income	Current % Allocation	Expected Tracking Error	TE Volatility
Manager A	50%	1.2%	4%
Manager B	50%	2.0%	4%
Benchmark	0%	0%	0%
Portfolio Managers US Equity	**% Allocation**	**Expected Tracking Error**	**TE Volatility**
Manager C	50%	3.6%	6%
Manager D	50%	2.4%	6%
Benchmark	0%	0%	0%

3. Health Insurance Companies

3.1. Background

AHA Health Insurance Company (AHA) is a large national insurer located in California with its home office in Los Angeles. AHA is wholly owned by Lyon Corporation. AHA is an insurance company and files a Blue Blank with the National Association of Insurance Commissioners (NAIC).

AHA Health provides basic life, health and disability benefits to its employees while they are employed by the company. These benefits do not continue after employees leave the company.

AHA Health sponsors a company-paid final-average-earnings defined benefit pension plan for its employees.

Active Choice Insurance Company (Active Choice) is a small local health insurance company domiciled in New York with its home office in Albany. Active Choice is a potential acquisition target for AHA. Active Choice is an HMO and files an Orange Blank with the NAIC.

3.2. Employee Benefits

AHA Health provides basic life, health and disability benefits to its employees while they are employed by the company. These benefits do not continue after employees leave the company.

AHA Health sponsors a company-paid final-average-earnings defined benefit pension plan for its employees.

Active Choice provides basic life, health and disability benefits to its employees while they are employed by the company. These benefits do not continue after employees leave the company.

Active Choice does not sponsor any pension or savings plans for its employees.

3.3. Product Lines

AHA sells individual and group insurance in California and 14 other states. It is in both the small and large group markets in all states. In addition, AHA has a small block of long term care (LTC) business with policyholders located all over the country.

Active Choice is in the small and large group markets in the state of New York.

3.4. Product Structure

AHA's policies include comprehensive major medical coverage of hospital services, physician services, and prescription drugs. The plans have an average deductible under $2,500 in all markets. In addition, the group policies include dental coverage. Dental is offered as a rider to the medical policies.

Active Choice's products include comprehensive major medical coverage of hospital services, physician services, dental services, and prescription drugs. The average deductible for Active Choice's plans is also under $2,500 in all markets. Dental is offered as a rider to medical.

3.5. Provider Networks & Medical Management

AHA has staff that negotiates with physician and hospital providers in each state in which it is licensed and continually monitors these provider networks. It has contracted with Networks 'R Us to use its provider networks when members need services outside of states in which it is licensed. In addition, AHA has contracted with Carefree Rx, a nationwide drug plan, to manage and administer its prescription drug coverage. Finally, AHA has a contract with Painless Dental to manage and administer its dental plans.

AHA has its own centralized medical management staff which administers its medical management policies consistently in all states in which it is licensed. AHA's staff continually reviews and revises policies to keep costs down and to keep up with the latest developments. Its vendors, Networks 'R Us, Carefree Rx, and Painless Dental, work with AHA to make sure their medical management policies do not conflict with those of AHA.

Active Choice has contracted with Networks 'R Us to use their provider networks for physician and hospital services. It also has contracts with Carefree Rx, a Prescription Benefit Management company (PBM), and Painless Dental to manage and administer their prescription drug and dental plans, respectively. In order to lower costs, it periodically puts its network contracts out to bid. While this may lower premiums it has been disruptive to members in the past.

Active Choice uses the standard medical management from its vendors. The company has a medical management staff who coordinates with the vendors' medical managers to ensure that the vendors meet New York requirements and that their policies are consistent with the Active Choice product language.

3.6. Operations

AHA has a claims system developed and maintained by a well-known and well-respected national vendor. AHA maintains a close relationship with this vendor in order to make sure that the system meets all of its needs. On the other hand, Active Choice has a “home grown” system that has performed well over the years. However, modifications are difficult and take time which has resulted in payment errors. Needless to say, their controls in many areas differ and some are drastically different.

Both companies underwrite small business coverage, but their procedures are very different. The advent of healthcare reform will bring their underwriting processes closer together. Both companies use credibility rating but have different points for determining whether a group is fully credible.

AHA is diligent in collecting data. Their information is categorized in a number of different ways that allows all parts of the company to use the same data base. For example, Medical Management can use the corporate database to determine which of its initiatives have been successful. Their data are used for research, forecasting, group reporting, and financial reporting. The group reports have proved helpful in showing groups how to lower their costs. Also, it is easy for AHA to do ad hoc financial analyses if problems arise. Active Choice stores its data mainly at the group level and use categories that allow it to do some detailed reporting to groups, pricing, monthly financial reporting and, of course, statutory reporting.

3.7. Management/Culture

Lyon Corporation management has little experience in health insurance. As result, they are content to allow the AHA management a great deal of autonomy and this arrangement has worked well in the past.

AHA’s management tends to be aggressive and willing to take risks. The fact that their business is spread over a large membership base in 15 states may give them a sense of security. On the other hand, the management of Active Choice appears to be more conservative. However, since their company covers the entire state of New York, they are adept at dealing in diverse markets (rural to cosmopolitan). Both management teams have generous incentive plans but requirements for receiving incentive payments differ. Finally, there are substantial cultural difference between the southern California AHA and the northeastern Active Choice management teams.

Neither company has a CRO. AHA has a risk committee with limited scope and authority and different senior managers take on a CRO role as needed.

Both organizations have incentive plans. AHA's plan criteria include membership growth, profitability, and quality of care. AHA's plan covers management staff from top management to frontline management. The goal is to have all management focused on the key drivers of success. Active Choice's plan only covers senior management and the incentives cover the direct responsibilities of each executive (e.g., the chief marketing officer is responsible for growth and the CFO is responsible for profitability). The goal of this plan is to make sure senior executives focus on their responsibilities and do not get sidetracked. Also, this type of plan ensures that management in the rest of the company does not make decisions directly affecting a given executive's area of the business.

3.8. Healthcare Reform & Other Regulatory Issues

AHA's staff has been following healthcare reform since its inception and has developed and updated detailed implementation plans. These include timelines and requirements for additional staff. The new staff members need to be hired in time to get at least 6 months of training. At this time, the funds for the new staff have not been approved so hiring has been put on hold.

The management of Active Choice has been following healthcare reform and has decided to use a vendor to help with the implementation. This will leave the current staff free to concentrate on the current business. Currently, Active Choice is negotiating with several vendors.

Next year, AHA with undergo its triennial audit by the California Department of Insurance. Management anticipates that there will not be any problems but this audit entails a substantial effort from Finance, Internal Audit, Actuarial, and other areas.

3.9. Going Forward

The corporate CFO of AHA is interested in hedging the LTC risk and has called together a team from AHA's finance and actuarial areas plus the corporate finance and investment areas to see how to move ahead with this idea. It would seem that the timing on this initiative is very apropos because the management of AHA is looking into purchasing a block of LTC business.

In addition, AHA is developing its strategy for the period after full implementation of the Affordable Care Act in 2014. AHA's claim experience varies dramatically by state and market (Individual, small Group, and Large Group). AHA must decide whether to pull out of certain markets, stay in the market and sell out of the Exchange, or remain in the market and sell through the Exchange. The Exchanges offer protection through the reinsurance program and the risk corridor program. However, any pricing error would be exploited very quickly for plans on the Exchange. A large volume of underpriced new business could be sold very quickly. Also, a rate increase would take months to implement given the new, time consuming rate approval process.

Finally, AHA management is looking into purchasing Active Choice. The driving force behind this acquisition is to help AHA enter a new market without having to build a lot of infrastructure. Initially, the Active Choice management would remain in place to run the company and integration would proceed over several years. AHA management is putting together a due diligence team including staff from corporate and AHA finance, actuarial, marketing, and medical management.

3.10. AHA Financial Statements

AHA Balance Sheet (in $millions)
12/31/2011

		Amount
1.	Cash and invested assets	$2,074.8
2.	Accident and health premiums due and unpaid	$86.6
3.	Amounts recoverable from reinsurers	$0.0
4.	Net credit for ceded reinsurance	$0.0
5.	All other admitted assets	$96.2
6.	**Total assets**	**$2,257.6**
7.	Claims unpaid	$335.0
8.	Accrued medical incentive pool and bonus payments	$0.8
9.	Premiums received in advance	$417.6
10.	Funds held under reinsurance treaties	$0.0
11.	Reinsurance in unauthorized companies	$0.0
12.	All other liabilities (balance)	$64.7
13.	**Total liabilities**	**$818.1**
14.	**Total capital and surplus (line 6 minus line 13)**	**$1,439.5**
15.	**Total liabilities, capital and surplus (line 13 + line 14)**	**$2,257.6**

AHA Transactions with Providers (in $millions)

		Direct Medical Expense Payment
Capitation Payments (in $millions)		
1.	Medical groups	$0.0
2.	Intermediaries	$160.4
3.	All other providers	$0.0
4.	**Total capitation payments**	**$160.4**
Other Payments (in $millions)		
5.	Fee-for-service	$186.6
6.	Contractual fee payments	$2,089.4
7.	Bonus/withhold arrangements: fee-for-service	$0.0
8.	Bonus/withhold arrangements: contractual fee payments	$0.0
9.	Non-contingent salaries	$0.0
10.	Aggregate cost arrangements	$523.5
11.	All other payments	$0.0
12.	**Total other payments**	**$2,799.5**
13.	**Total (line 4 + line 12)**	**$2,959.9**

AHA Premiums, Enrollment and Utilization

		Comprehensive Hospital & Medical			
		Individual	Group	Long Term Care	Total
Total Members at the end of:					
1.	Prior Year	491,895	327,930	25,000	844,825
2.	First Quarter, Current Year	485,345	313,125	25,520	823,990
3.	Second Quarter, Current Year	490,635	310,530	31,225	832,390
4.	Third Quarter, Current Year	483,480	302,175	32,255	817,910
5.	Fourth Quarter, Current Year	498,565	307,755	35,000	841,320
6.	Current Year Member Months	5,932,065	3,730,860	372,515	10,035,440
Total Members Ambulatory Encounters for Year:					
7.	Physician	4,862,445	3,473,175	1,735	8,337,355
8.	Non-Physician	290,100	200,070	19,975	510,145
9.	Total	5,152,545	3,673,245	21,710	8,847,500
10.	Hospital Patient Days Incurred	90,360	75,300	1,880	167,540
11.	Number of Inpatient Admissions	21,400	19,455	195	41,050
Premiums, Written and Earned (in $millions)					
12.	Health Premiums, Written	$2,176.2	$1,674.0	$41.8	$3,891.9
13.	Life Premiums, Direct	$0.0	$0.0	$0.0	$0.0
14.	Property & Casualty Premiums, Written	$0.0	$0.0	$0.0	$0.0
15.	Health Premiums, Earned	$2,176.2	$1,674.0	$41.8	$3,891.9
16.	Life Premiums, Earned	$0.0	$0.0	$0.0	$0.0
17.	Property & Casualty Premiums, Earned	$0.0	$0.0	$0.0	$0.0
Claims, Paid and Incurred (in $millions)					
18.	Amount Paid for Provision of Health Care Services	$1,637.2	$1,309.7	$13.1	$2,960.0
19.	Amount Incurred for Provision of Health Care Services	$1,630.1	$1,304.1	$13.0	$2,947.2
Member Ambulatory Encounters for Year - Per 1,000					
7.	Physician	9,836	11,171	56	9,969
8.	Non-Physician	587	644	644	610
9.	Total	10,423	11,815	700	10,580
10.	Hospital Patient Days Incurred	183	242	61	200
11.	Number of Inpatient Admissions	43	63	6	49
Premiums, Written and Earned - PMPM					
12.	Health Premiums, Written	$366.85	$448.68	$112.17	$387.82
13.	Life Premiums, Direct	$0.00	$0.00	$0.00	$0.00
14.	Property & Casualty Premiums, Written	$0.00	$0.00	$0.00	$0.00
15.	Health Premiums, Earned	$366.85	$448.68	$112.17	$387.82
16.	Life Premiums, Earned	$0.00	$0.00	$0.00	$0.00
17.	Property & Casualty Premiums, Earned	$0.00	$0.00	$0.00	$0.00
Claims, Paid and Incurred -PMPM					
18.	Amount Paid for Provision of Health Care Services	$275.99	$351.06	$35.11	$294.95
19.	Amount Incurred for Provision of Health Care Services	$274.79	$349.54	$34.95	$293.68

AHA Income Statement, in $millions
December 31, 2011
(Prior to Minimum Loss Ratio Rebate Calculation)

	Comprehensive Hospital and Medical			
	Individual	Group	Long Term Care	Total
1. Net Premiums	$2,176.2	$1,674.0	$41.8	$3,891.9
2. Net Investment Income	$17.4	$13.4	$10.4	$41.2
3. Total Revenue (1 + 2)	$2,193.6	$1,687.4	$52.2	$3,933.2
4. Accident & Health Benefits	$1,630.1	$1,304.1	$13.0	$2,947.2
5. Increase in Aggregate Reserves	$32.6	$25.1	$8.4	$66.1
6. Total (4 + 5)	$1,662.7	$1,329.2	$21.4	$3,013.3
7. Commissions	$108.8	$83.7	$3.3	$195.8
8. General Insurance Expenses	$176.3	$135.6	$3.4	$315.2
9. Insurance Taxes, Licenses and Fees	$65.3	$50.2	$1.3	$116.8
10. Total Expenses (7 + 8 + 9)	$350.4	$269.5	$8.0	$627.8
11. Total Benefits and Expenses (6 + 10)	$2,013.1	$1,598.7	$29.4	$3,641.2
12. Net Gain From Operations Before FIT (3 less 11)	$180.5	$88.7	$22.9	$292.0
13. Federal Income Taxes	$63.2	$31.0	$8.0	$102.2
14. Net Gain From Operations After FIT (12 less 13)	$117.3	$57.6	$14.9	$189.8

AHA Experience by State

2011 AHA Experience by State
Group Medical

	NV	OR	WA	CA	IL	IN	NJ	MI
Small Group								
Direct Premium (in $millions)	$156.2	$31.7	$14.1	$147.0	$14.1	$69.0	$92.8	$24.8
Direct Claims (in $million)	$129.0	$25.0	$11.6	$92.5	$10.7	$57.9	$78.9	$16.7
Direct Loss Ratio	82.6%	79.0%	82.0%	62.9%	75.6%	83.9%	85.0%	67.5%
Member Months	305,725	51,910	20,410	155,975	32,425	180,570	243,830	91,885
Earned Premium - PMPM	$511.05	$610.25	$691.55	$942.53	$435.85	$381.88	$380.75	$269.83
Incurred Claims - PMPM	$422.00	$482.12	$567.10	$593.24	$329.66	$320.57	$323.65	$182.25
Large Group								
Direct Premium (in $millions)	$194.5	$35.6	$20.5	$313.2	$133.0	$22.6	$163.1	$43.4
Direct Claims (in $millions)	$151.8	$31.0	$12.1	$249.0	$97.1	$20.0	$133.7	$35.3
Direct Loss Ratio	78.0%	87.0%	58.9%	79.5%	73.0%	88.7%	82.0%	81.4%
Member Months	454,345	59,380	35,075	631,100	331,850	55,290	371,645	143,920
Earned Premium - PMPM	$428.14	$599.82	$583.06	$496.32	$400.79	$408.01	$438.82	$301.37
Incurred Claims - PMPM	$334.06	$521.87	$343.58	$394.60	$292.66	$362.00	$359.85	$245.30
All								
Direct Premium (in $millions)	$350.8	$67.3	$34.6	$460.2	$147.1	$91.5	$255.9	$68.2
Direct Claims (in $millions)	$280.8	$56.0	$23.6	$341.6	$107.8	$77.9	$212.7	$52.1
Direct Loss Ratio	80.1%	83.2%	68.4%	74.2%	73.3%	85.1%	83.1%	76.4%
Member Months	760,070	111,290	55,485	787,075	364,275	235,860	615,475	235,805
Earned Premium - PMPM	$461.49	$604.68	$622.97	$584.75	$403.91	$388.00	$415.81	$289.08
Incurred Claims - PMPM	$369.43	$503.33	$425.80	$433.96	$295.95	$330.28	$345.51	$220.73
Individual Medical								
Direct Premium (in $millions)	$487.7	$98.9	$44.1	$458.9	$44.1	$215.2	$289.8	$77.4
Direct Claims (in $millions)	$412.1	$76.8	$35.5	$267.5	$32.8	$177.6	$242.1	$51.4
Direct Loss Ratio	84.5%	77.6%	80.6%	58.3%	74.3%	82.5%	83.5%	66.4%
Member Months	1,208,665	205,225	80,690	616,635	128,190	713,870	963,965	363,260
Earned Premium - PMPM	$403.50	$481.82	$546.01	$744.18	$344.13	$301.51	$300.62	$213.05
Incurred Claims - PMPM	$340.96	$374.09	$440.03	$433.83	$255.79	$248.74	$251.13	$141.42

AHA Experience by State (continued)

Group Medical

	SC	TN	TX	OH	GA	KY	WI	Total
Small Group								
Direct Premium (in $millions)	$5.0	$14.6	$23.2	$40.6	$46.8	$12.8	$4.3	$697.2
Direct Claims (in $million)	$3.1	$10.1	$17.6	$32.3	$31.1	$10.7	$4.2	$531.4
Direct Loss Ratio	61.0%	69.4%	75.8%	79.5%	66.4%	83.4%	95.6%	76.2%
Member Months	14,660	40,350	71,710	125,355	123,110	31,735	10,835	1,500,485
Earned Premium - PMPM	$343.86	$361.75	$323.14	$323.91	$380.29	$404.06	$401.28	$464.63
Incurred Claims - PMPM	$209.89	$251.21	$244.99	$257.48	$252.60	$337.01	$383.64	$354.15
Large Group								
Direct Premium (in $millions)	$9.6	$0.3	$3.8	$4.9	$16.7	$8.4	$7.2	$976.8
Direct Claims (in $millions)	$10.5	$0.1	$2.0	$4.4	$14.4	$5.1	$6.2	$772.7
Direct Loss Ratio	108.9%	25.9%	51.2%	90.0%	86.3%	60.4%	86.9%	79.1%
Member Months	25,875	1,100	10,435	16,810	47,380	25,780	20,390	2,230,375
Earned Premium - PMPM	$371.75	$311.31	$365.79	$292.61	$351.54	$327.45	$351.51	$437.95
Incurred Claims - PMPM	$404.97	$80.77	$187.40	$263.43	$303.51	$197.89	$305.63	$346.44
All								
Direct Premium (in $millions)	$14.7	$14.9	$27.0	$45.5	$63.5	$21.3	$11.5	$1,674.0
Direct Claims (in $millions)	$13.6	$10.2	$19.5	$36.7	$45.5	$15.8	$10.4	$1,304.1
Direct Loss Ratio	92.5%	68.4%	72.3%	80.6%	71.6%	74.3%	90.2%	77.9%
Member Months	40,535	41,450	82,145	142,165	170,490	57,515	31,225	3,730,860
Earned Premium - PMPM	$361.66	$360.41	$328.56	$320.21	$372.30	$369.72	$368.78	$448.68
Incurred Claims - PMPM	$334.42	$246.69	$237.67	$258.18	$266.74	$274.65	$332.70	$349.54
Individual Medical								
Direct Premium (in $millions)	$15.7	$45.6	$72.3	$126.7	$146.1	$40.0	$13.6	$2,176.2
Direct Claims (in $millions)	$9.4	$31.1	$53.9	$99.0	$95.4	$32.8	$12.8	$1,630.1
Direct Loss Ratio	60.0%	68.2%	74.5%	78.1%	65.3%	82.0%	94.0%	74.9%
Member Months	57,955	159,520	283,500	495,580	486,705	125,460	42,845	5,932,065
Earned Premium - PMPM	$271.51	$285.62	$255.13	$255.75	$300.26	$319.03	$316.76	$366.85
Incurred Claims - PMPM	$162.87	$194.93	$190.09	$199.79	$196.00	$261.50	$297.61	$274.79

3.11. Financial Statements for Active Choice

Active Choice Balance Sheet (in $millions)
12/31/2011

		Amount
1.	Cash and invested assets	$111.7
2.	Accident and health premiums due and unpaid	$18.3
3.	Amounts recoverable from reinsurers	$0.0
4.	Net credit for ceded reinsurance	$0.0
5.	All other admitted assets	$83.9
6.	**Total assets**	**$213.9**
7.	Claims unpaid	$32.1
8.	Accrued medical incentive pool and bonus payments	$0.3
9.	Premiums received in advance	$3.7
10.	Funds held under reinsurance treaties	$0.0
11.	Reinsurance in unauthorized companies	$0.0
12.	All other liabilities (balance)	$88.2
13.	**Total liabilities**	**$124.3**
14.	**Total capital and surplus (line 6 minus line 13)**	**$89.6**
15.	**Total liabilities, capital and surplus (line 13 + line 14)**	**$213.9**

Active Choice Transactions with Providers (in $millions)

		Direct Medical Expense Payment
Capitation Payments (in $millions)		
1.	Medical groups	$0.0
2.	Intermediaries	$0.0
3.	All other providers	$0.0
4.	**Total capitation payments**	**$0.0**
Other Payments (in $millions)		
5.	Fee-for-service	$178.5
6.	Contractual fee payments	$80.2
7.	Bonus/withhold arrangements: fee-for-service	$0.1
8.	Bonus/withhold arrangements: contractual fee payments	$0.1
9.	Non-contingent salaries	$0.0
10.	Aggregate cost arrangements	$0.0
11.	All other payments	$3.8
12.	**Total other payments**	**$262.7**
13.	**Total (line 4 + line 12)**	**$262.7**

Active Choice Premiums, Enrollment and Utilization

		Comprehensive Hospital & Medical Group Policies
Total Members at the end of:		
1.	Prior Year	114,360
2.	First Quarter, Current Year	66,825
3.	Second Quarter, Current Year	68,740
4.	Third Quarter, Current Year	61,135
5.	Fourth Quarter, Current Year	54,145
6.	Current Year Member Months	770,170
Total Members Ambulatory Encounters for Year:		
7.	Physician	237,070
8.	Non-Physician	216,225
9.	Total	453,295
10.	Hospital Patient Days Incurred	14,985
11.	Number of Inpatient Admissions	3,675
Premiums, Written and Earned (in $millions)		
12.	Health Premiums, Written	$303.7
13.	Life Premiums, Direct	$0.0
14.	Property & Casualty Premiums, Written	$0.0
15.	Health Premiums, Earned	$307.2
16.	Life Premiums, Earned	$0.0
17.	Property & Casualty Premiums, Earned	$0.0
Claims, Paid and Incurred (in $millions)		
18.	Amount Paid for Provision of Health Care Services	$262.7
19.	Amount Incurred for Provision of Health Care Services	$243.3
Member Ambulatory Encounters for Year - Per 1,000		
7.	Physician	9,836
8.	Non-Physician	587
9.	Total	10,423
10.	Hospital Patient Days Incurred	183
11.	Number of Inpatient Admissions	43
Premiums, Written and Earned - PMPM		
12.	Health Premiums, Written	$394.27
13.	Life Premiums, Direct	$0.00
14.	Property & Casualty Premiums, Written	$0.00
15.	Health Premiums, Earned	$398.91
16.	Life Premiums, Earned	$0.00
17.	Property & Casualty Premiums, Earned	$0.00
Claims, Paid and Incurred - PMPM		
18.	Amount Paid for Provision of Health Care Services	$341.14
19.	Amount Incurred for Provision of Health Care Services	$315.93

Active Choice Income Statement, in $millions
December 31, 2011
(Prior to Minimum Loss Ratio Rebate Calculation)

	Comprehensive Hospital and Medical Group	Total
1. Net Premiums	$307.2	$307.2
2. Net Investment Income	$1.5	$1.5
3. Total Revenue (1 + 2)	$308.8	$308.8
4. Accident & Health Benefits	$243.3	$243.3
5. Increase in Aggregate Reserves	$6.1	$6.1
6. Total (4 + 5)	$249.5	$249.5
7. Commissions	$15.4	$15.4
8. General Insurance Expenses	$36.9	$36.9
9. Insurance Taxes, Licenses and Fees	$9.2	$9.2
10. Total Expenses (7 + 8 + 9)	$61.4	$61.4
11. Total Benefits and Expenses (6 + 10)	$310.9	$310.9
12. Net Gain From Operations Before FIT (3 less 11)	($2.1)	($2.1)
13. Federal Income Taxes	($0.8)	($0.8)
14. Net Gain From Operations After FIT (12 less 13)	($1.4)	($1.4)

2011 Active Choice Experience by State
Group Medical

	NY
Small Group	
Direct Premium (in $millions)	$156.2
Direct Claims (in $million)	$139.1
Direct Loss Ratio	89.0%
Member Months	305,725
Earned Premium – PMPM	$511.05
Incurred Claims – PMPM	$454.83
Large Group	
Direct Premium (in $millions)	$151.0
Direct Claims (in $million)	$104.3
Direct Loss Ratio	69.1%
Member Months	464,445
Earned Premium – PMPM	$325.10
Incurred Claims – PMPM	$224.50

Total

Direct Premium (in $millions)	$307.2
Direct Claims (in $million)	$243.3
Direct Loss Ratio	79.2%
Member Months	770,170
Earned Premium - PMPM	$398.91
Incurred Claims - PMPM	$315.93

3.12. Correspondence

The memos and emails on the following pages provide some information about the AHA's activities. Some of the correspondence relates to a potential acquisition of a closed block of long term care business, while other correspondence relates to Active Choice.

3.12.1. Memorandum - Bigger Actuarial Consulting - LTC Acquisition

Date: April 30, 2011

Subject: LTC Acquisition

To: B. G. Bucks, CFO AHA

From: Joe Cool, FSA, MAAA

I have done a preliminary investigation of your acquisition target and have the following observations:

- This is a large closed block of LTC business which is close to the same size as AHA's block of LTC.
- The block is administered using a home grown system and we need to make sure that it is compatible with the AHA system.
- Many of the products generate cash values.
- In addition to the purchase price, AHA will need to make sure that policy and claims reserves are adequate and that the assumption underlying cash value calculations are reasonable.
- The current owner of the block has not filed for a rate increase since the inception of the product.

Please let me know how you would like to proceed.

3.12.2. AHA Internal Memorandum - Confidential - Active Choice Acquisition

Date: May 15, 2011

Subject: Active Choice Acquisition

To: B. G. Bucks, CFO AHA

From: G. O. Getter, MBA, Project Manager

I have been working with our consultant and broker on this project and I believe it is an important and exciting opportunity for our organization. Our consultant's actuaries and financial folks asked that I pass along several minor details that they have found while digging around in the publically available data and financials. They say they need to look at these areas more closely during due diligence.

- The company is winding down its large group business.
- They think the medical loss ratio is low.
- Broker fees and administrative costs are a bit high.
- Low surplus backed by illiquid assets.

None of these items are insurmountable, especially considering our financial strength and marketing expertise. As a result, I do not see any deal breakers here.

Again, I cannot stress enough the fact that this is an important and exciting opportunity.

3.12.3. AHA Internal Memorandum - Confidential - Pension Plan Funding

Date: September 30, 2011

Subject: Pension Plan Funding

To: B. G. Bucks, CFO AHA

From: I. M. Caring, VP HR

As you know, AHA sponsors a company-paid final-average-earnings defined benefit pension plan for its employees, whereas Active Choice does not sponsor any pension or savings plans for its employees.

Historically, assets in the AHA Salaried Pension Plan fund have been invested in the same manner as assets in the Simple Life Salaried Pension Plan fund.

Reports from the AHA Salaried Pension Plan's actuary indicate that, over the past five years:

(a) Unfunded actuarial liabilities have been somewhat volatile, ranging from approximately $10.7 million to $60.8 million (the most recent actuarial report indicated unfunded actuarial liabilities of $23.7 million. Unfunded actuarial liabilities must be amortised, in accordance with government regulations, by cash contributions.
(b) Pension expense, which is reported on the company's financial statements, has also been somewhat volatile, ranging from $15.5 million to $30.0 million. Pension Expense for the most recent fiscal year was $28.3 million.

As mentioned above, Active Choice does not sponsor any pension or savings plans for its employees. At this point, we have not had any discussions about how to deal with Active Choice employees, should AHA decide to acquire Active Choice.

3.12.4. AHA E-Mail - Underwriting Procedural Changes

Date: June 30, 2011

Subject: Underwriting Procedural Changes

To: B. G. Bucks, CFO AHA

From: Rick Averse, U/W Manager

As you know, the Underwriting staff is stretched pretty thin due to our involvement in new initiatives and the hold on hiring. As a result, we have come up with some ways to try to keep things moving without increasing our risk.

- The actuarial department will give us trend assumptions and benefit relativities. We will not accept this data from other sources. We are seeing a lot of new benefit designs so the actuaries will be doing more for us than in the past. Also, I have not spoken with them about this since I wanted your opinion and support first.
- We will use discretion on rating cases.
- During busy time, we will have marketing do field underwriting on some of our simpler cases. The marketing staff is very enthusiastic about this idea.

Please let me as soon as you can if we can move ahead. Thanks.

3.12.5. AHA E-Mail - New Claims Administration Update

Date: September 30, 2011

Subject: New Claims Administration System Update

To: B. G. Bucks, CFO AHA; Ace Ventura, FSA, AHA Valuation Actuary; Sal Bidness, AHA Chief Marketing Officer

From: Bob Smith, AHA VP Operations

Installation of the new claims system is going as well as can be expected. We have gotten a bit behind since some of the IT folks have been reassigned and our vendor found a software problem which will take a couple of weeks to fix.

I just wanted to remind all of you that the last time we performed maintenance on our system, we were unable to pay claims for 2 weeks. As a result, I have approved overtime for the claims processors so that we can bring down our claims inventories as much as possible before we move to the new system. There will probably still be some delay in payments but we think we have minimized the impact.

We had hoped that we would be able to run dual systems so as not to disrupt our operations, but that will not be feasible.

Let me know if you have any questions.

3.13. AHA Salaried Pension Plan

The following pages contain financial and demographic information about the AHA Salaried Pension Plan, as well as information about the Statement of Funding Policies and Procedures for the Plan and the Statement of Investment Policies and Procedures for the Plan.

AHA, through its Board of Directors, has delegated responsibility for the day-to-day management of the Plan to the Vice-President, Human Resources and the Chief Financial Officer. The CFO's focus is on financial reporting and cash contribution requirements, the VP HR is largely responsible for all other activities.

3.13.1. Pension Plan - Benefit Provisions and Financial Information

The information on the following pages enumerates the current provisions of the Pension Plan and provides certain historical financial information. Historical financial information is not available prior to January 1, 2007.

AHA Salaried Pension Plan

Eligibility	Immediate
Vesting	100% after 5 years of plan membership
Normal Retirement Age	65
Early Retirement Age	55 with 5 years of plan membership
Best Average Earnings	Average earnings during 60 consecutive months of highest earnings
Earnings	Base Pay, excluding overtime and bonuses
Normal Retirement Benefit	1% of best average earnings times service years, subject to maximum
Accrued Benefit	Benefit calculated as under the normal retirement benefit formula using best average earnings and service as the valuation date
Early Retirement Benefit	Accrued benefit reduced on an actuarial equivalent basis for all members
Form of Benefit	Single life annuity
Optional Forms of Benefit	None
Indexing	None
Termination Benefit	(1) Lump sum value equal to actuarial present value of accrued pension payable at age 65; or (2) Deferred pension
Pre-Retirement Death Benefit	Lump sum value equal to actuarial present value of accrued pension payable at age 65 to named beneficiary
Disability Benefit	Accrual of service while on long term disability and immediate pension without a reduction upon permanent and total disability

AHA Salaried Pension Plan
Historical Actuarial Valuation Results

Participant Summary - January 1

	2007	**2008**	**2009**	**2010**	**2011**
Active Participants					
(a) count	3,759	4,197	5,017	4,826	5,027
(b) average age	37.8	37.9	39.2	40.3	40.6
(c) average service	7.5	6.9	6	6	5.9
(d) average future working lifetime	20	20	20	20	20
(e) average plan earnings (prior year)	61,800	63,400	72,900	75,000	80,500
Deferred Vested Participants					
(a) count	-	-	-	-	-
Pensioners (incl beneficiaries)					
(a) count	237	251	262	277	315
(b) average age	76.8	76.8	74.2	74.5	74.8
(c) average annual benefit	15,400	15,500	16,100	16,000	16,200

Plan Assets (numbers in $000's) *

	2007	2008	2009	2010	2011
Change in Plan Assets during Prior Year:					
Market Value of Assets at January 1 of prior year	-	96,024	110,852	92,799	133,829
Employer Contributions during prior year	-	12,408	16,706	31,980	26,461
Benefit Payments during prior year	-	(4,550)	(5,791)	(7,218)	(5,532)
Expenses during prior year	-	-	-	-	-
Investment return during prior year	-	6,969	(28,969)	16,269	14,531
Market Value of Assets at January 1 of current year	96,024	110,852	92,799	133,829	169,289
Rate of return during prior year	0%	7%	-25%	15%	10.1%
Average Portfolio Mix During Prior Year:					
(a) Domestic Large Cap Equities	0%	40%	39%	33%	36%
(b) Domestic Small Cap Equities	0%	20%	20%	15%	16%
(c) Domestic Fixed Income	0%	30%	30%	42%	39%
(d) International Equities	0%	4%	4%	5%	4%
(e) Real Estate	0%	4%	4%	2%	3%
(f) Cash	0%	2%	2%	3%	2%
(g) Total	0%	100%	100%	100%	100%
Asset Class Returns during Prior Year:					
(a) Domestic Large Cap Equities	0%	5%	-37%	26%	15%
(b) Domestic Small Cap Equities	0%	9%	-45%	28%	5%
(c) Domestic Fixed Income	0%	7%	5%	6%	7%
(d) International Equities	0%	16%	-6%	-17%	13%
(e) Real Estate	0%	6%	-63%	51%	29%
(f) Cash	0%	5%	2%	0%	0%

** numbers may not add due to rounding*

AHA Salaried Pension Plan
Historical Actuarial Valuation Results

Actuarial Valuation - January 1 (numbers in $000's) *

	2007	**2008**	**2009**	**2010**	**2011**
1. Actuarial Accrued Liability:					
(a) Active participants	76,035	92,741	114,322	121,670	144,470
(b) Deferred vested participants	-	-	-	-	-
(c) Pensioners	30,658	33,458	39,229	41,218	48,479
(d) Total	106,694	126,200	153,551	162,888	192,949
2. Actuarial Value of Assets	96,024	110,852	92,799	133,829	169,289
3. Unfunded Actuarial Accrued Liability: (1d)-(2)	10,669	15,347	60,753	29,059	23,660
4. Normal Cost (beg. Of year)	10,138	13,441	19,054	20,278	24,486
5. Change in Unfunded AAL during prior year:					
(a) Unfunded AAL at prior valuation date	-	10,669	15,347	60,753	29,059
(b) Adjustment for Interest	-	720	998	3,949	1,889
(c) Normal Cost w/interest less contributions	-	(2,005)	(2,935)	(12,727)	(5,725)
(d) (Gain)/Loss on investment	-	(223)	36,529	(9,432)	(5,152)
(e) (Gain)/Loss on salary increases less than expected	-	(908)	10,432	(1,310)	4,153
(f) (Gain)/Loss on assumption changes	-	9,875	0	7,656	1,697
(g) (Gain)/Loss on all other factors	-	(2,782)	381	(19,829)	(2,261)
(h) Unfunded AAL at current valuation date	10,669	15,347	60,753	29,059	23,660
6. Actuarial Basis					
(a) Interest	6.75%	6.50%	6.50%	6.50%	6.00%
(b) Salary scale	3.75%	4.00%	4.00%	4.00%	3.50%
(c) Consumer Price Index	3.00%	3.00%	3.00%	3.00%	2.50%
(d) Mortality	UP 1994 AA15	UP 1994 AA15	UP 1994 AA15	1994 Uninsured Pensioner Mortality - Generational	1994 Uninsured Pensioner Mortality - Generational
(e) Turnover			None		
(f) Retirement age			Age 65		
(g) Proportion married and age difference			Not Applicable		
(h) Expenses			Assume all expenses paid by company		
(i) Asset Valuation Method			Market value of assets		
(j) Actuarial Cost Method			Projected unit credit		

** numbers may not add due to rounding*

AHA Salaried Pension Plan
Historical Actuarial Valuation Results

Expense Valuation - January 1 (numbers in $000's) *	**2007**	**2008**	**2009**	**2010**	**2011**
1. Reconciliation of funded status at valuation date:					
(a) Accrued Benefit Obligation (ABO)	(97,661)	(93,740)	(130,024)	(137,815)	(152,350)
(b) Projected Benefit Obligation (PBO)	(130,116)	(126,200)	(175,847)	(186,598)	(206,454)
(c) Fair Value of Assets	96,024	110,852	92,799	133,829	169,289
(d) Funded Status: (b) + (c)	(34,091)	(15,347)	(83,048)	(52,769)	(37,165)
(e) Unamortized net actuarial gain)/loss	42,093	20,299	90,715	62,417	45,445
(f) Accrued benefit asset/(liability)	8,002	4,951	7,667	9,647	8,280
2. Pension Expense:					
(a) Service Cost (beg. of year)	13,048	13,441	22,545	23,994	26,635
(b) Interest Cost	8,453	8,888	11,687	12,470	13,244
(c) Expected return on assets	(7,497)	(8,723)	(7,888)	(10,822)	(12,583)
(d) Amortization of past service cost	-	-	-	-	-
(e) Amortization of net actuarial (gain)/loss	1,454	384	3,657	2,188	1,240
(f) Pension Expense for year	15,459	13,990	30,000	27,829	28,536
3. Actuarial Basis and Supplemental Data					
(a) Discount rate	6.00%	6.50%	6.00%	6.00%	5.75%
(b) Return on assets	7.50%	7.50%	7.50%	7.50%	7.00%
(c) Salary scale	3.75%	3.50%	3.50%	3.50%	3.00%
(d) Consumer Price Index	3.00%	3.00%	3.00%	2.50%	2.50%
(e) Mortality	UP 1994 AA15	UP 1994 AA15	UP 1994 AA15	1994 Uninsured Pensioner Mortality - Generational	1994 Uninsured Pensioner Mortality - Generational
(f) Turnover			None		
(g) Proportion married and age difference			Not Applicable		
(h) Retirement age			Age 65		
(i) Expenses			Assume all expenses paid by company		
(j) Asset Valuation Method			Market value of assets		
(k) Actuarial Cost Method			Projected unit credit		
(l) Employer contributions	12,408	16,706	31,980	26,461	26,461
(m) Benefit payments	(4,550)	(5,791)	(7,218)	(5,532)	(5,532)

** numbers may not add due to rounding*

AHA Salaried Pension Plan

Reconciliation of Plan Participants (2008 - 2011)

	Active	Pensioners/ Beneficiaries	Total
1. Participants as of January 1, 2007	**3,759**	**237**	**3,996**
- New Entrants/Rehires	617	-	617
- Terminated Nonvested	(73)	-	(73)
- Terminated Vested (Lump Sum Cashout)	(87)	-	(87)
- Retirement	(17)	17	-
- Death w/ Beneficiary	(2)	-	(2)
- Deaths	-	(3)	(3)
- Net change	438	14	452
2. Participants as of January 1, 2008	**4,197**	**251**	**4,448**
- New Entrants/Rehires	1,385	-	1,385
- Terminated Nonvested	(269)	-	(269)
- Terminated Vested (Lump Sum Cashout)	(285)	-	(285)
- Retirement	(11)	11	-
- Death w/ Beneficiary	-	3	3
- Deaths	-	(3)	(3)
- Net change	820	11	831
3. Participants as of January 1, 2009	**5,017**	**262**	**5,279**
- New Entrants/Rehires	271	-	271
- Terminated Nonvested	(269)	-	(269)
- Terminated Vested (Lump Sum Cashout)	(163)	-	(163)
- Retirement	(26)	26	-
- Death w/ Beneficiary	(4)	3	(1)
- Deaths	-	(14)	(14)
- Net change	(191)	15	(176)
4. Participants as of January 1, 2010	**4,826**	**277**	**5,103**
- New Entrants/Rehires	459	-	459
- Terminated Nonvested	(122)	-	(122)
- Terminated Vested (Lump Sum Cashout)	(88)	-	(88)
- Retirement	(44)	44	-
- Death w/ Beneficiary	(4)	2	(2)
- Deaths	-	(8)	(8)
- Net change	201	38	239
5. Participants as of January 1, 2011	**5,027**	**315**	**5,342**

AHA Salaried Pension Plan
Age/Svc/Earnings as of January 1, 2011

			Service (Years) < 5	5-10	10-15	15-20	>20	Totals
Age (Years)	< 25	# Participants	220	-	-	-	-	220
		Average Salary	36,000	-	-	-	-	36,000
	25-35	# Participants	1,125	536	12	-	-	1,673
		Average Salary	55,900	73,500	74,700	-	-	61,700
	35-45	# Participants	598	584	308	34	5	1,529
		Average Salary	79,000	88,400	101,700	98,100	141,100	87,800
	45-55	# Participants	408	263	86	66	68	891
		Average Salary	91,800	101,800	100,200	133,100	131,100	101,600
	55-65	# Participants	320	172	84	58	-	634
		Average Salary	95,100	105,000	85,100	96,000	-	96,500
	> 65	# Participants	72	8	-	-	-	80
		Average Salary	96,000	105,200	-	-	-	96,900
	Totals	# Participants	2,743	1,563	490	158	73	5,027
		Average Salary	70,300	87,500	97,900	111,900	131,800	80,500

Avg Age	40.6
Avg Svc	5.9
Avg Salary	80,500

AHA Pension Plan			
Interest Sensitivity and Cash Flows			
	Actives	Pensioners	Total
Rate	Liabilitiy	Liabilitiy	Liabilitiy
6.00%	144,470,323	48,478,500	192,948,823
5.50%	161,562,552	50,274,659	211,837,211
6.50%	129,537,476	46,794,590	176,332,066
Duration (5.5%)	22.2	7.2	18.4
Convexity (5.5%)	597.9	92.6	470.9
Five Years	Actives	Pensioners	Total
Ending Dec 31	Cash Flow	Cash Flow	Cash Flow
2017	3,664,621	23,878,862	27,543,483
2022	10,487,888	20,551,640	31,039,528
2027	36,101,345	16,216,539	52,317,885
2032	85,602,936	11,052,980	96,655,916
2037	112,201,991	6,132,117	118,334,109
2042	111,018,528	2,575,053	113,593,581
2047	101,999,865	770,824	102,770,689
2052	85,533,058	149,502	85,682,561
2057	61,302,312	17,194	61,319,506
2062	37,699,639	1,091	37,700,730
2067	20,053,305	36	20,053,341
2072	9,241,645	1	9,241,646
2077	3,536,911	0	3,536,911
2082	1,000,803	0	1,000,803
2087	164,549	0	164,549
2092	12,311	0	12,311

3.13.2. Statement of Funding Policies and Procedures - AHA Health

The Company has prepared a Statement of Funding Policies and Procedures ("Statement") to document the governance of the Plan. The Company has also prepared a Statement of Investment Policies and Procedures. Extracts of the Statement are provided below followed by a summary of the Statement contents.

3.13.2.1. Allocation of Responsibilities

The Company has delegated the management of Plan funding as follows:

The Company, acting through Management, will:

- Establish, review and amend, as required, the Statement of Funding Policies and Procedures;
- Select the Pension Consultant and the Actuary;
- Review funding reports prepared by the Actuary regarding the funding of the Plan; and
- Be responsible for the assumption or delegation of any responsibilities not specifically mentioned.

The Pension Consultant and Actuary will:

- Assist, as required, the Company in the preparation of the Statement of Funding Policies and Procedures;
- Present to the Company, as required by the Statement of Funding Policies and Procedures, reviews and reports regarding the funding of the Plan; and
- Comment to the Company on any changes in plan design, contribution flow or pension legislation that may affect the funding of the Plan.

3.13.2.2. Funding Policy Principles

The Company is the primary risk bearer under the Plan. As a result, the funding objective of the Company is the accumulation of assets which will secure the Plan's benefits in respect of service already rendered. The accumulation of assets should be reasonable, without significant volatility or further recourse to the Company's assets.

The Company believes management of the Plan on a going concern basis is the most suitable means to achieve these objectives.

3.13.2.3. Management of Risks

The Company has adopted the following policies to mitigate their risks:

- Going-concern valuations are to be prepared using best estimate assumptions adjusted to include margins for adverse deviation. The Company will consult with the Pension Consultant and Actuary regarding the adoption of margins for adverse deviation.

- Emerging experience will differ from the assumptions made for going-concern purposes. The Pension Consultant and Actuary will monitor emerging experience and recommend revisions to the going-concern assumptions as appropriate.
- Plan provisions are managed to mitigate, to the extent possible, demographic and economic risks. Benefit improvements under the Plan will be made with due regard to the Plan's funded status.
- Investment activity will be carried out with due regard to the liability structure of the Fund, to the cash flow requirements of the Fund, and to the risks and rewards inherent in the defined benefit investments. The Statement of Investment Policies and Procedures documents the Company's policies regarding investment risk.

3.13.2.4. Funding Target

The funding target for the Plan is to have a funded ratio (assets divided by liabilities) of 100% on a going-concern basis.

3.13.2.5. Funding Risks

- The Company bears the following funding risks:
- The Plan's demographic experience may differ from best-estimate assumptions.
- The Plan's economic experience may differ from best-estimate assumptions. In addition to investment risks, the Company bears the risks associated with providing a final average earnings benefit.
- The Plan's liabilities are debt-like in nature and have a long term to maturity. As a result of the current investment strategy and nature of the Plan's liabilities, there is the risk of an asset-liability mismatch.

*   *   *   *   *   *   *   *

The contents of the Statement follow:

- PURPOSE
- BACKGROUND, PLAN TYPE AND LIABILITIES
- ALLOCATION OF RESPONSIBILITIES
- FUNDING POLICY PRINCIPLES
- FUNDING RISKS
- MANAGEMENT OF RISKS
- FUNDING TARGET
- ELIMINATION OF DEFICITS
- UTILIZATION OF EXCESSES

- FREQUENCY OF VALUATIONS
- COMMUNICATION
- APPENDIX 1 – Summary of Roles
- APPENDIX 2 – Summary of Liabilities, Assets and Membership Data
- APPENDIX 3 – History of SFP&P Review and Amendments

3.13.3. Statement of Investment Policies and Procedures - Excerpts

Following are excerpts from the Statement of Investment Policies and Procedures for the AHA Health Insurance Company's Pension Plan.

3.13.3.1. Investment Risk

- Investment risk is borne by the Company
- Going-concern surplus, subject to any legislative restrictions, can be applied against the Company's Normal Actuarial Cost

3.13.3.2. Allocation of Responsibilities

The Company, acting through Management, will:

- Establish, review and amend, as required, the Statement of Investment Policies and Procedures;
- Select one or more fund managers ("Fund Managers"), the Pension Consultant and the Actuary;
- Select the Custodian to hold pension fund assets;
- Review the performance of the Fund and the Fund Managers at least annually; and
- Be responsible for the assumption or delegation of any responsibilities not specifically mentioned.

The Fund Managers will:

- Manage the asset mix and select securities within each Investment Fund Option, subject to applicable legislation and the constraints set out in this Statement.

The Pension Consultant and Actuary will:

- Assist, as required, the Company in the preparation of the Statement of Investment Policies and Procedures; and
- Comment to the Company on any changes in plan design or contribution flow that may affect the investment of assets.

The Custodian will:

- Fulfil the regular duties required by law of the Custodian in accordance with the Plan;
- Participate in annual reviews of the Statement of Investment Policies and Procedures;
- Present to the Company, at least annually, reviews and reports of investment performance of the Fund Managers;
- Provide the Company with monthly updates on the performance of the Fund Managers;
- Provide the Company with information, on an ongoing basis, about changes at the Fund Managers that could affect investment performance;
- Present to the Company, at least annually, reviews and reports of all investment Fund assets and transactions for the period;
- Monitor actual investments as appropriate to ensure compliance with the Pension Benefits Act; and
- Rebalance the Plan portfolios as requested by the Company.

3.13.3.3. Investment Objectives

- to preserve the capital;
- to provide sufficient funds to meet payments as they become due; and
- to maintain sufficient assets over actuarial requirements to meet unforeseen liabilities.

3.13.3.4. Rate of Return Objectives

(a) to achieve an average annual rate of return, net of investment expenses, of at least the funding valuation rate of return (currently 6.0%) per year, measured over moving, four-year periods;
(b) to achieve top third performance, relative to the peer group of fund managers, measured over moving, four-year periods;
(c) to exceed the passive benchmark for the Pension Fund by 1.00% per annum, measured on a four-year moving average basis; and
(d) to achieve at least the increase in the Consumer Price Index plus 3%, on a four-year moving average basis.

3.13.3.5. Asset Allocation Guidelines

The following normal policy allocation, and associated range for strategic deviation at any time, has been adopted by the Company:

Percentages of Fund at Market Value	**Normal**	**Minimum**	**Maximum**
Domestic Equities	40%	30%	50%
International Equities	20%	15%	25%
Domestic Fixed Income (duration of 5)	30%	15%	45%
Real Estate (Private)	4%	0%	8%
Private Equity	4%	0%	8%
Cash	2%	0%	4%

Within the ranges noted above, the Fund Managers may actively vary the asset mix in an effort to achieve the investment objectives of the Company.

3.13.3.6. Passive Management Objectives

The rate of return expected to be achieved through passive management of the assets in the Plan Fund will be based on the normal allocation of assets. The passive return shall be set equal to the sum of:

(a) 45.0% of the S&P 500 Index return for the year;
(b) 20.0% of the MSCI EAFE Index return for the year; and
(c) 35.0% of the Barclays Capital Aggregate Bond Index return for the year.

3.13.3.7. Rebalancing

The Company will direct the re-balancing of the assets in the component pooled funds, when it deems rebalancing to be appropriate.

3.13.3.8. Related Party Transactions

A “Related Party” is:

(a) the Company, acting as Plan Administrator,
(b) an officer, director or employee of the Company,
(c) the funding agent or person responsible for investing the assets of the Plan, or any officer, director or employee thereof,
(d) an association or trade union representing employees of the Company, or an officer or employee thereof,
(e) an employer who participates in the Plan, or an employee, officer or director thereof,
(f) the Plan Participant,
(g) a person (including spouse or child) directly or indirectly holding more than 10% of the voting shares of the Company,
(h) the spouse or child of (a) to (g),
(i) an affiliate of the Company,
(j) a corporation directly or indirectly controlled by a person in (a) to (h),
(k) an entity in which a person in (a), (b), (e) or (g), has a substantial investment (where “substantial investment” means more than 25% of the ownership interests in an unincorporated entity, more than 10% of the voting rights of a corporation or more than 25% of the shareholders’ equity in a corporation) or,
(l) an entity with substantial investment in the Company.

“Related Parties” excludes government or a financial institution holding Plan assets if not the administrator.

The Company, acting as Plan Administrator, shall not, directly or indirectly:

(a) lend the assets of the Plan to a Related Party or invest those assets in the securities of a Related Party; or
(b) enter into a transaction with a Related Party on behalf of the Plan, subject to a minimum limit of $50,000 per transaction and a cumulative limit of $250,000 in a Plan’s fiscal year.

Related Party transactions are acceptable provided they are necessary for the operation of the Plan and are purchased on terms and conditions that are at least as favourable for the Plan as are otherwise available.

3.13.4. Appendix: Economic Data

The investment consultant for AHA's DB Plan has provided the following information:

AHA DB Plan	Market Value ($000)	Duration	KRD 1 Yr	KRD 3 Yr	KRD 5 yr	KRD 10 Yr	KRD 20 Yr	KRD 30 Yr
Plan Actives	144,470	22.2	0.01	0.04	0.15	2.00	7.30	12.70
Plan Pensioners	48,479	7.2	0.20	0.55	1.40	2.75	1.90	0.40
Plan Total Liabilities	192,949	18.4	0.05	0.15	0.45	2.20	5.95	9.60

	Equity Indices		**Barclay's Capital U.S. Bond Indices**	
	S&P 500	**MSCI EAFE**	**Aggregate**	**Aggregate 10+ Year Maturity**
Expected Returns	6.50%	8.00%	2.30%	3.00%
Annualized Volatility	15.05%	16.88%	3.73%	10.02%
Duration	0.00	0.00	5.01	14.19
Skewness	-0.67	-0.77	-0.41	0.03
Kurtosis	4.22	4.51	4.82	5.56

	Equity Indices		**Barclay's Capital U.S. Bond Indices**	
Correlations	**S&P 500**	**MSCI EAFE**	**Aggregate**	**Aggregate 10+ Year Maturity**
S&P 500	1.00			
MSCI EAFE	0.79	1.00		
Aggregate	0.06	0.04	1.00	
Aggregate 10+ Year Maturity	-0.10	-0.05	0.90	1.00

AHA DB Plan:

Fixed Income Portfolio Managers	Current % Allocation	Expected Tracking Error	TE Volatility
Manager E	50%	1.50%	3%
Manager F	50%	2.00%	4%
Benchmark	0%	0%	0%
Equity Portfolio Managers	Current % Allocation	Expected Tracking Error	TE Volatility
Manager G	50%	4.00%	5%
Manager H	50%	3.50%	7%
Benchmark	0%	0%	0%

4. Pryde Property & Casualty

4.1. Overview

Pryde is an Omaha, Nebraska-based U.S. writer with commercial and personal lines products that target niche market customers. The split between commercial and personal lines is 66.7%/33.3% respectively. Pryde is licensed in all 50 states and its products are sold through a unified sales force, led by sales directors responsible for selecting the product, managing the agency delivery system and serving the business in their territory. The company has approximately $1.0 billion in assets and $287 Million in Capital and Surplus.

ADMITTED ASSETS	12/31/2011	12/31/2010
Bonds	521,896	388,171
Preferred stock	23,475	21,205
Common stock	9,938	6,870
Cash & short-term invest	38,759	54,641
Other non-affil inv asset	10,846	10,220
Investments in affiliates	28,663	23,397
Total invested assets	633,577	504,504
Premium balances	239,342	148,913
Accrued interest	6,459	4,920
All other assets	152,628	73,999
Total assets	1,032,006	732,337

LIABILITIES & SURPLUS	12/31/2011	12/31/2010
Loss & LAE reserves	318,776	228,254
Unearned premiums	226,121	191,026
Conditional reserve funds	202	39
All other liabilities	200,090	49,614
Total liabilities	745,190	468,933
Total Policyholder Surplus	286,816	263,404

4.2. Employee Benefits

Pryde provides basic life, health and disability benefits to its employees while they are employed by the company. These benefits do not continue after employees leave the company.

Pryde does not sponsor any pension or savings plans for its employees.

4.3. Production

Business is produced through independent agents and general agents, as well as exclusive career agents on a national basis. Pryde's strategy is centered on serving highly focused customer segments in both personal and commercial lines of business. Customer service is rated highly as evidenced in consistently high customer retention levels.

4.4. Target Markets

The commercial business unit focuses on three defined groups of customers:

- School Districts
- Municipalities
- Non-Profit Social Clubs

Of the three markets, School Districts make up the largest portion of the commercial business at approximately 85%, with Municipalities, and Non-Profit Social Clubs comprising 10% and 5% respectively, of the commercial business. The three major lines of business written are:

- Commercial Multi-Peril ("CMP")
- Workers Compensation
- Commercial Auto

The personal lines business unit currently focuses on the major market segment of individuals affiliated with School Districts. Homeowners and Standard Automobile are the major lines of business that make up the personal lines segment. The company writes standard automobile coverage for both customer groups within this relationship market, which consist of total abstainers from alcohol and "responsible choice" households.

Pryde writes approximately $700 Million of Gross Written Premium.

Line	Written Premium Direct	Written Premium Net	% of NPW	Pure Loss Ratio	Loss & LAE Reserves
Commercial MultiPeril	294,650	213,671	41.8	66.5	184,973
Workers Comp	77,111	74,269	14.5	77.2	100,566
Private Pass Auto Liability	72,350	71,861	14.1	39.4	-7,171
Auto Physical	59,953	59,610	11.7	43.7	-2,814
Homeowners	41,622	30,363	5.9	40.6	7,445
Other Liability Occur	32,620	27,932	5.5	34.9	13,720
Commercial Auto Liability	25,849	24,189	4.7	55.0	15,056
Allied Lines	75,132	4,576	0.9	42.4	730
All Other	17,289	4,153	0.8	46.6	6,272
Totals	696,575	510,623	100.0	56.8	318,776

4.5. Regional Spread

Pryde's direct business is geographically spread throughout the United States with its largest state (California) representing 17% of total premium volume. The next largest states include Texas, (6.0%); Georgia (5.5 %); Florida (5.4%); Mississippi (5.3%); 46 other jurisdictions, (61.3%).

4.6. Exited Markets

Beginning in 2005, Pryde's previous management team followed a growth and acquisition strategy and decentralization of its operations, which led to rate inadequacy and significant adverse loss reserve development. Pryde seeks to develop and expand its total insurance relationship by cross-selling tailored products and services to its targeted customer groups. Pryde experimented with a specialty market, which included non-standard automobile, recreational vehicle and specialty homeowners business, but subsequently exited the specialty market since it was not consistent with Pryde's targeted customer groups. The specialty markets contained customer groups whose nature was to purchase a single product at a time, often based on price.

Prior to 2009, Pryde had experienced a significant reduction in its capital and surplus position. The reduction was due primarily to a decline in underwriting performance from aggressive growth in these specialty lines of business, followed by significant loss reserve charges. The costs associated with buying and subsequently selling or discontinuing those businesses further contributed to the reduction. Exiting the specialty markets resulted in significant improvement in earnings in 2010, driven by an improvement in underwriting results, despite reporting continued adverse loss reserve development.

4.7. Underwriting Results

Year	Net UW Income ($000)	Loss Ratios			Expense Ratios			Div. Pol.	Comb Ratio
		Pure Loss	LAE	Loss& LAE	Net Comm	Other Exp.	Total Exp.		
2007	-48,325	67.5	13.5	81.0	9.8	20.5	30.3	0.0	111.3
2008	-83,108	77.0	19.6	96.6	3.9	22.8	26.6	0.0	123.2
2009	-64,932	74.9	15.1	90.0	6.8	20.7	27.5	0.0	117.5
2010	-3,336	57.0	14.6	71.6	8.3	18.0	26.3	0.1	97.9
2011	-646	56.8	13.1	69.9	11.7	16.5	28.1	0.1	98.1
5-Yr Avg		66.2	15.0	81.2	8.4	19.5	27.9	0.0	109.1

Pryde has been challenged by significant adverse loss reserve development in recent years. This has impacted both non-continuing and continuing books of business.

	Original Loss Reserves	Developed Through 2011	Developed to Orig (%)
2006	289,253	366,439	26.7%
2007	284,434	364,107	28.0%
2008	207,151	291,178	40.6%
2009	174,612	200,808	15.0%
2010	204,842	210,589	2.8%
2011	290,194	290,194	

4.8. Investment Income

Pryde has generally produced favorable investment yield from a pre-dominantly fixed income portfolio that has outperformed industry composite averages. Invested assets are comprised primarily of a bond portfolio diversified among corporate, tax-exempts, and US Government Obligations. The company’s stated investment strategy is simple: preserve capital while maintaining the predictability of return on investment without incurring undue risk. Hence, the strategy focuses on fixed income rate investments held for long term investment. Affiliated investments relate to Pryde Services, a wholly owned entity that provides services for Pryde Property & Casualty.

Asset Class	Assets ($000)
Long-Term bonds	521,896
Stocks	33,413
Affiliated Investments	28,663
Other Inv Assets	56,064
Total	640,036

Asset Class	% of Total Bonds	Mkt Val to Stmt Val(%)	Avg. Maturity (Yrs)	Class 1 - 2 (%)	Class 3 - 6 (%)	Struc. Secur. (%)	Struc. Secur. (% of PHS)
Governments	22.3	1.8	4.7	100.0	...	...	...
States, terr & poss	28.8	1.0	7.1	100.0	...	71.1	37.2
Corporates	48.9	1.6	5.7	98.5	1.5	6.5	5.8
Total all bonds	100.0	1.5	5.9	99.2	0.8	23.6	43.0

4.9. Catastrophe Exposure

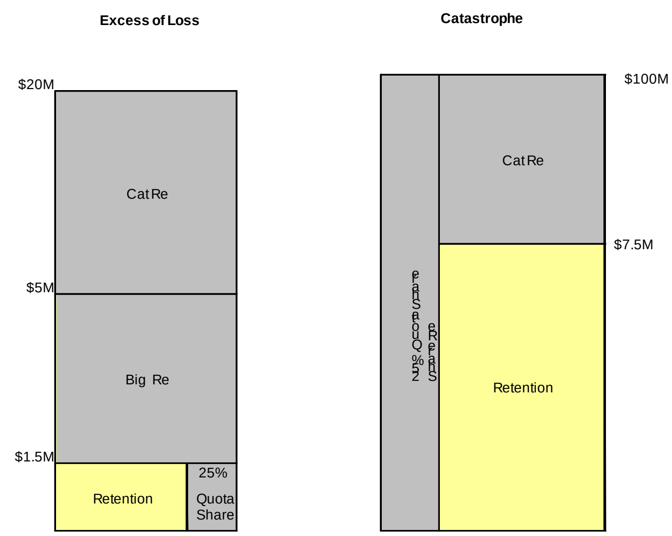
The group's primary catastrophe exposure stems from both hurricanes and earthquakes. However, these exposures are mitigated through excess of loss reinsurance, as well as catastrophe protection that has enabled the group to improve its net catastrophe leverage to a very manageable level. As a result, the group's net probable maximum losses (PML) stemming from a combined 250-year hurricane and a 250-year earthquake depicted in a PML analysis represents approximately 5% of capital and surplus.

4.10. Reinsurance

Pryde reinsures with high-quality reinsurers utilized by the company.

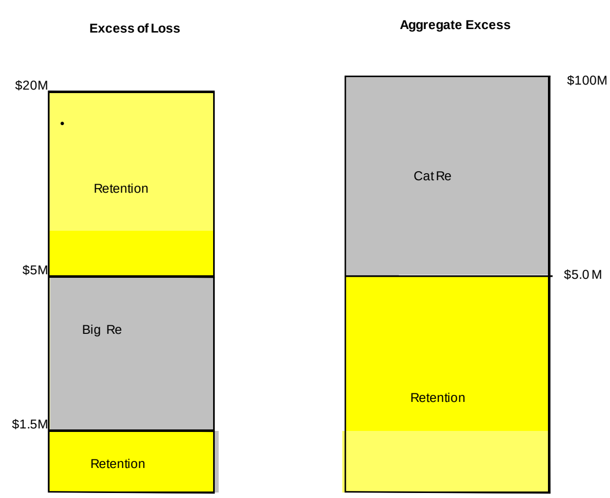
4.11. Property Risks

Pryde cedes away 25% of the ground-up first $1.5 million/claim via a quota-share reinsurance treaty with SHARE Re. In addition Pryde owns a multi-line working layer excess-of loss reinsurance treaty with BIG Re, where Pryde cedes each $3.5 million excess of $1.5 million claim for property risks subject to a $7.5 million per occurrence aggregate limit. Protection is further supplemented with both an additional excess layer and a property catastrophe cover with CAT Re for $92.5 million in excess of $7.5 million per Occurrence Aggregate Limit.



4.12. Casualty Risks

Working layer treaty reinsurance with Big Re includes one multi-line $3.5 Million excess of $1.5 Million for casualty risks and $3.5 Million per occurrence. An aggregate excess of loss treaty with Cat Re covers losses excess of $5.0 Million.



4.13. Total Available Capital

The proper assessment of an insurer's true financial strength requires appraisal of its total balance sheet on an integrated basis under a system that depends upon realistic values (economic values) and consistent treatment of both assets and liabilities, and that does not generate a hidden surplus or deficit. To convert the statutory capital figures to economic capital levels, adjustments are necessary. Statutory accounting principles deviate from economic valuations in several ways, including, but not limited to, the following:

- Acquisition Costs are not deferred
- Bonds in good standing are valued at amortized value--not market value
- Loss and loss adjustment expense reserves do not reflect the time value of money
- Carried statutory reserves do not reflect inherent reserve margins (e.g. carried reserves being redundant or deficient)

4.14. Rating Agency Review

Best's rates Pryde as an A-, reflecting the company's adequate capitalization, improved operating results and liquidity and its niche market presence. The Company's positive rating also considers its nationally recognized position in its core business. Pryde's strong reputation and dedicated product and service capabilities have enabled it to sustain strong market penetration. The rating also reflects the corrective actions taken by management to improve operating performance and enhance balance sheet strength.

Partially offsetting these positive factors are the company's significant adverse reserve development on prior accident years and its dependence on reinsurance. A.M. Best remains concerned over the potential for additional adverse loss reserve development and its impact on near-term operating performance and overall capitalization.

Pryde's overall capitalization as measured by Best's Capital Adequacy Ratio (BCAR) is adequate for its A- rating.

4.15. Economic Capital Model

Pryde had retained Hawthorne Consulting in 2010 to aid the company in developing a "risk and capital" model that would aid management in gauging the adequacy of overall capitalization of the company and in allocating resultant capital to target lines of business or niche business segments. Pryde wishes to gauge the risk adjusted return on capital (RAROC) by segment to aid in its business planning for 2011 and beyond. In essence, Pryde's goal is to improve its ability to better manage capital and return. Underlying this goal, Hawthorne advises on three underlying themes:

- Capital Productivity
- Capital Protection
- Capital Adequacy

Hawthorne's thought leadership focuses on the notion that there is a trade-off between having enough capital to minimize insurance company failures and having the minimum amount of capital so capital can be deployed. As such, Hawthorne recommended using a risk adjusted return on required capital (RAROC) approach. In essence, this approach considers both how much Pryde is earning on the capital that is committed to the business and how much capital is needed to ensure that policyholders are paid in the event of a stress scenario. Hawthorne argues that RAROC addresses the aforementioned trade-off between capital productivity and capital adequacy. To set a target or requirement for the amount of capital that should be held by an insurance company or group requires a clear vision of the purposes for which capital is held. Effectively defined capital requirements serve several purposes, including, but not limited to:

- Providing funds so Pryde is able to honor its obligations during adverse contingent events.
- Motivating a company to avoid undesirable levels of risk
- Promoting a risk management culture to the extent that capital requirements are a function of actual economic risk

Economic capital should be what Pryde requires for ongoing operations and what it must hold in order to gain the necessary confidence of the marketplace, its policyholders, its investors, and its regulatory supervisors. The operations of Pryde, on the other hand, after the net effect of all the inherent risks, must yield a rate of return deemed reasonable by the providers of the insurer's capital.

4.16. Appendix

- Consultant's Report - Executive Summary and Recommendations @9/30/10
- Consultant's Report - Background, Terminology, Considerations

4.16.1. Consultant's Report- Executive Summary 9/30/10

Pryde has asked Hawthorne to consult and help in developing a "risk and capital" model that would aid management in gauging the adequacy of overall capitalization of the company and in allocating capital to target line of business or niche business segments to aid in its business planning for 2011 and beyond.

In considering the trade-off between having enough capital to minimize insurance company failures and having the minimum amount of capital so capital can be deployed, Hawthorne recommends a risk adjusted return on required capital (RAROC) approach in measuring returns. This approach considers both how much Pryde is earning on the capital that is committed to the business and how much capital is needed to ensure that policyholders are paid in the event of a stress scenario.

Economic capital is the capital required to buffer the policyholder from default up to a target solvency or rating standard (e.g. A.M. Best's). We estimated Capital Requirements for Pryde by calibrating overall risk at a 99.4% VaR risk metric (i.e., capital needed to assure that there is only a 0.6% chance all of the capital will be depleted). This is consistent with an A+ rating.

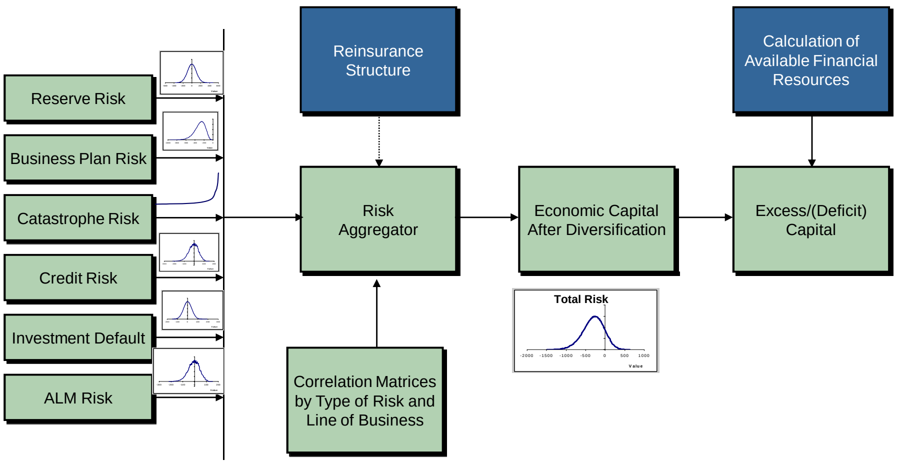
We used the following two risk metrics in gauging Pryde's Capital Needs:

- Value at Risk (VaR)
- Tail Value at Risk (TVaR)

Briefly, the "Value at Risk" (VaR) risk metric measures a percentile of a cumulative probability distribution (e.g., the 95th percentile of the distribution is the value for which there is a 5% probability of exceeding that value).

TVaR is similar to VaR risk metric but considers all possibilities beyond the above VaR threshold in that it reflects the average of all possible values beyond a defined percentile (e.g., TVaR 95% is the arithmetic average of all possible VaRs beyond the 95th percentile of the distribution).

Economic capital assessment was based on a multi-step process beginning with a bottom-up analysis of individual risks.



The first column below reflects how much stand-alone capital is needed per the 99.4% VaR for each risk separately. This totaled a sum of $377.1M of economic capital. In consideration of correlation and diversification effects, this sum is reduced by 30.5% resulting in a total needed capital of approximately **$262.2 Million.**

RISK TYPE	STANDALONE ECONOMIC CAPITAL REQUIREMENTS	DIVERSIFIED CAPITAL AS A PERCENT OF STANDALONE	DIVERSIFIED ECONOMIC CAPITAL REQUIREMENTS
RESERVE	$90.6	73.9%	$66.9
BUSINESS PLAN	$112.3	83.5%	$93.8
CATASTROPHE	$22.2	51.7%	$11.5
CREDIT (RECOVERABLES)	$48.4	75.0%	$36.4
INVESTMENT	$22.3	15.6%	$3.5
ALM	$81.2	61.8%	$50.2
TOTAL	$377.1	69.5%	$262.2

This, compared to the available economic capital of $269.9 Million, places Pryde in a favorable capital position relative to the risk metrics utilized.

Line of business and niche contributions to the overall capital needs of Pryde appear below. The marginal contribution percentages are then used to allocate the overall Pryde capital by line of business and niche. The exhibit below displays the indicated $262.2 million allocated to lines of business. In addition, the line of business expected RAROCs are computed below. RAROCs are based on expected 2011 profitability per Pryde's business plan relative to the allocated capital.

Note- The TVaR 98.0% risk metric was used in this approach, as we deemed it appropriate to consider the extreme tail in the respective risk distributions in developing the inherent contribution and hence allocation share. As the line of business marginal contributions to the Company's overall capital needs are sensitive to extreme events, we feel this approach makes sense.

Line of Business	**Marginal Capital**	**Allocated Economic Capital**	**Economic Profit**	**Premium**	**Economic Profit (%Prem)**	**Marginal Returns**	**Return on Economical Capital**	**Premiums to Economic Capital**
CPP-Prop	39,454	54,756	641	116,821	0.5%	1.6%	1.2%	2.1
Homewoners	7,407	10,279	540	32,306	1.7%	7.3%	5.2%	3.1
Personal Auto	14,282	19,822	4,035	132,049	3.1%	28.3%	20.4%	6.7
Workers Compensation	34,961	48,521	10,097	75,722	13.3%	28.9%	20.8%	1.6
BAP	9,043	12,550	3,418	28,432	12.0%	37.8%	27.2%	2.3
Umbrella	14,289	19,831	11,564	23,996	48.2%	80.9%	58.3%	1.2
CPP-Liability-Other	25,751	35,738	9,811	53,763	18.2%	38.1%	27.5%	1.5
CPP-Liability-SLC	31,899	44,271	4,795	34,425	13.9%	15.0%	10.8%	0.8
CPP-Liability-SM	11,828	16,415	2,444	11,708	20.9%	20.7%	14.9%	0.7
Total		**262,184**	**47,344**	**509,221**	**9.3%**		**18.1%**	**1.9**

Niche	Marginal Capital	Allocated Economic Capital	Economic Profit	Premium	Economic Profit (% Prem)	Return on Economic Capital	Premiums to Economic Capital
School Districts	107,494	148,100	23,538	246,769	9.5%	15.9%	1.7
Municipalities	18,951	26,110	4,434	36,435	12.2%	17.0%	1.4
Social Clubs	41,357	56,980	14,798	61,662	24.0%	26.0%	1.1
Personal Lines	22,497	30,995	4,574	164,355	2.8%	14.8%	5.3
Total		262,185	47,344	509,221	9.3%	18.1%	1.9

4.16.1.1. Observations

Social Clubs are providing a greater RAROC than the other three niches. Growing this niche, all other things equal, would contribute to a higher total RAROC.

The optimum target market distribution by niche would be such that the marginal returns are identical by niche, all others things being equal.

1. Pryde is expected to write at a little more than a 1.9 to 1 premium to capital ratio with an 18.1% return on the required capital of $262.2 Million. The marginal RAROCs suggest that the Company may optimize its overall RAROC by altering its mix by niche, given the current capital structure, specifically by growing in Social Clubs and declining in the others. The optimum equilibrium mix by niche would follow until all of the niches generate the same marginal RAROCs.

Note –Our analysis considers business plan risk as the uncertainty of deviating from the business plan targets/baselines. Our detailed approach and assumptions are presented in the following sections of the report.

4.16.2. Consultant's Report - Background, Terminology, Considerations

Prior to 2007, Pryde had experienced a significant reduction in its surplus position due primarily to a decline in underwriting performance from aggressive growth in non-core lines of business followed by significant loss reserve charges.

Pryde's goal is to improve its ability to better manage capital and return. Underlying this goal, Hawthorne defines three underlying themes:

- Capital Productivity
- Capital Protection
- Capital Adequacy

4.16.2.1. Degree of Protection

The strength of an insurer's capital can be thought of as the probability that a company's assets backing liabilities, together with capital, will be sufficient to satisfy all of its obligations to its policyholders. It should be noted that it is virtually impossible to have enough capital to totally prevent insurance company failures. Excess capital, while affording perhaps additional solvency protection, would, on the other hand, impede capital investment in insurers because the additional cost of capital may not be compensated for in the pricing of the insurer's policies. Hence excess capital has the potential to either raise the cost of insurance to a company's policyholders or to prevent a market from existing. On the other hand, insufficient capital, in comparison with that deemed necessary by modeling all of the appropriate risk factors at an adequate level of confidence, may result in inadequate pricing and will increase the exposure of the insurer, over time, to the risk of insolvency. Hence there is a constant trade-off between having enough capital to minimize insurance company failures and maintaining the minimum amount of capital so capital can be deployed effectively.

4.16.2.2. Time Horizon Considerations of Capital Needs

An insurer's financial statements are usually prepared at the end of each fiscal year—a considerable task that requires significant preparation time. Often there is a significant delay of several months between the statement date and the actual finalizations of company financials. This aspect is also followed by the timing and implementation of business plan actions, which may be corrective or opportunistic with regards to company decision-making. In the meantime, during the decision-making phase, the company would continue to operate and conduct business. We suggest an appropriate time horizon for considering an insurer's capital needs as one year from the evaluation date of the existing risk and return profile. This time horizon should not be confused with the full term of all of the assets and obligations of the insurer. The amount of required economic capital must be sufficient with a high level of confidence to meet all obligations for the time horizon as well as the present value at the end of the time horizon of the remaining future obligations.

In the course of this type of analysis, considerations should always be given to the notion that there is a trade-off between having enough capital to minimize insurance company failures and maintaining the minimum amount of capital so that capital can be deployed elsewhere, more effectively. As such, we recommend using a risk adjusted return on required capital (RAROC) approach in measuring returns. Our RAROC approach in essence considers both how much Pryde is earning on the capital that is committed to the business and how much capital is needed to ensure that policyholders are paid in the event of a stress scenario. Hence RAROC addresses the aforementioned trade-off between capital productivity and capital adequacy.

Three Specific Themes

Capital Productivity

- **Are we earning an acceptable return on capital?**
- **Are we generating enough capital to support any expansion plans?**
- **Based on risk-adjusted rates of return on capital, in what lines of business, products, or niches should we expand or contract?**

Capital Protection

- **Have we identified our risks, and can we produce a distribution of outcomes?**
- **Which risks contribute the most to the capital needs of Hawthorne ?**
- **Do we have the optimum reinsurance structure in place?**

Capital Adequacy

- **Do we have the right level of capital given our risks and solvency standards?**
- **What level of capital do we need to target or attain a specific AM Best rating?**

Risk Adjusted Return on Capital

An economic capital and RAROC framework provides the measures needed to better manage risk and return.

$$\textbf{RAROC} = \frac{\textbf{Risk-Adjusted Return}}{\textbf{Economic Capital}}$$

*How much am I earning on the capital that I have committed to the business to satisfy the **shareholder** (policyholder)?*

CAPITAL PRODUCTIVITY

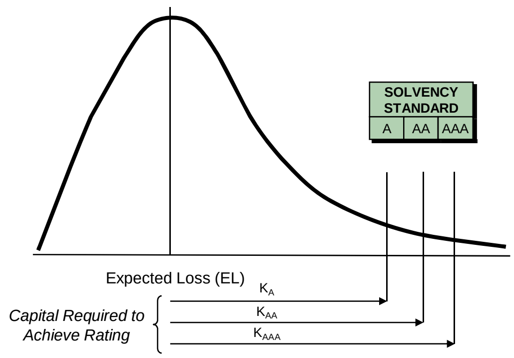
Compare RAROC with Hurdle Rate

*How much capital is needed to ensure that **policyholders** are paid in the event of a stress scenario?*

CAPITAL ADEQUACY

Compare Economic Capital with Available Financial Resources (AFR)

<u>ECONOMIC CAPITAL</u> IS DEFINED AS THE AMOUNT OF CAPITAL REQUIRED TO ACHIEVE A TARGET SOLVENCY STANDARD BASED UPON THE FIRM-WIDE LOSS DISTRIBUTION



- Economic capital is the capital required to buffer the policyholder from default up to a target solvency standard (and thus confidence interval)
- For the same risk profile, an institution targeting a better credit rating will need to hold more capital (AA institutions require more capital than single A)

4.16.2.3. Uncertainty vs. Volatility

It is generally accepted that uncertainty risk, the risk that models used to estimate claims or other relevant processes are mis-specified, (e.g. best point estimate of loss reserves) must be considered for the full remaining term of the insurance contracts. Uncertainty risk is widely believed to be non-diversifiable since it cannot be relatively reduced by increasing insured portfolio size. On the other hand, some argue that volatility risk, the risk of random fluctuations in either the frequency or severity, of contingent events, can be ignored in the long run, since these risks can be diversified away in the future. We believe that this notion is not universally true as some volatility risk cannot be diversified away. While true that in fully efficient markets, volatility would not be valued in the calculation of the fair value of a set of projected future cash flows, insurance markets are relatively inefficient. Hence capital supports both types of risk; both volatility and uncertainty. We doubt that every risk can be classified as one or the other in practice, as many types of risk may have both systematic and diversifiable elements. Moreover, this distinction may also depend on insurer size and the characteristics of the markets in which it operates.

4.16.2.4. Consideration of Risk Transfer

Last but not least, total capitalization should also take into account risk transfer mechanisms that reduce the risks of the insurer, such as the purchase of reinsurance, hedging, and securitization. Although the role of reinsurance is to transfer underwriting and reserve risks, consideration should still be given to recoverable risk as previously defined. It is also important to analyze the risk transfer structure in any reinsurance contract. Finite risk deals, for example, are structured to provide financing by reinsurers with, at times, a minimal amount of risk transfer.

Hedging can be considered natural or constructed. Natural hedges occur when a company can offset risks in different lines of business. Financial hedges on the other hand, involving the use of derivative instruments, can offset certain financial guarantees with respect to interest rates and or equity markets.

4.16.2.5. Correlation and Diversification

Our risk-based approach to required capital treats each source of risk separately (e.g., initial capital amounts are determined in silos). Total Capitalization, however, needs to recognize the relationships among the various risk sources that can affect the company's operations. As such, total capitalization should reflect risk concentration, diversification, and interdependencies.