

EDUCATION AND EXAMINATION COMMITTEE  
OF THE  
SOCIETY OF ACTUARIES

COURSE 8 FINANCE AND ENTERPRISE RISK MANAGEMENT STUDY NOTE

**COURSE 8 FINANCE AND ENTERPRISE RISK MANAGEMENT CASE STUDY**

Copyright 2004 by the Society of Actuaries

The Education and Examination Committee provides study notes to persons preparing for the examinations of the Society of Actuaries. They are intended to acquaint candidates with some of the theoretical and practical considerations involved in the various subjects. While varying opinions are presented where appropriate, limits on the length of the material and other considerations sometimes prevent the inclusion of all possible opinions. These study notes do not, however, represent any official opinion, interpretations or endorsement of the Society of Actuaries or its Education and Examination Committee. The Society is grateful to the authors for their contributions in preparing the study notes.

# **Course 8 Finance/ERM**

**Case Study**

**Fall 2004**

## **Zoolander Life**

**It's your life!**

## From the desk of Charley Pigeon

To: You, the New CFO

Welcome to the Zoolander team. Tomas Lyon, our CEO, is out of the country for the month but asked me to put together some background information for you. I'm attaching a number of documents that I found in your predecessor's files; hopefully this will keep you busy for a while.

I think that you'll find your time here both challenging and rewarding and look forward to working with you.

Cheers,

Charley

**From the desk of Tomas Lyon**

July 2, 2004

Re New CFO

Congratulations. As I write this, you have yet to be hired but I need to welcome you in advance as I am spending the months of July and August at my villa in Tuscany. You have been through a rigorous screening process. I have every confidence that the search committee has picked the right person for this important position. I am sure you will do a fine job as Zoolander Life's new Chief Financial Officer.

Anyway, you have a lot of work to do. Your predecessor, Mr. A. Hugh Dodo, left to pursue other opportunities at a critical time for Zoolander Life. My executive assistant, Mr. Charley Pigeon, will help you get settled in your new position.

Ideally we would have all the issues that you will face as our new CFO laid out similar to a fancy case study. Well, the real world is not that neat. Charley has been instructed to pull together memos, e-mails and other documents to help you familiarize yourself with the company and the issues in the Finance Department.

This job will be a real test. I am counting on you to learn quickly and to make decisions that will put our company on a firm financial footing.

In an emergency situation, Pigeon knows how to contact me.

Very Sincerely

R. Tomas Lyon, IV  
Chairman, President, CEO and COO  
Zoolander Life Insurance Company

Cc Charley Pigeon

# Zooslander Life Insurance Company

as of June 30, 2004

**OFFICE OF THE CHAIRMAN**  
 R. Tomas Lyon  
 Chairman, President, CEO, COO

Charley Pigeon  
 Executive Assistant

**ADMINISTRATION**  
 Odette Bird  
 Senior VP, Administration

**Claims**  
 Claudette Dove  
 2nd VP, Administration

**Shellbyville Office**  
 Danny Swan  
 2nd VP, Administration

**Springfield Office**  
 Erika Swan  
 2nd VP, Administration

**CORPORATE SERVICES**  
 Kate Finch  
 Sr. VP, Chief Counsel

**Corporate Relations**  
 Fabian Crabb  
 Asst Vice President

**Human Resources**  
 Nicholas Sable  
 2nd VP, HR

**Information Technology**  
 Frances Seal  
 2nd VP, IT

**Legal**  
 Mindy Wren  
 Associate Counsel

**FINANCE**  
 <open>  
 VP, Chief Financial Officer

**Accounting**  
 Juan Bass  
 Chief Accounting Officer

**Actuarial**  
 Wanda Fox  
 Chief Actuary

**Investments**  
 Peter Fish  
 Chief Investment Officer

**Treasury**  
 Earl Tem  
 Corporate Treasurer

**MARKETING**  
 Danielle Wolfe  
 VP, Chief Marketing Officer

**Annuity Products**  
 Sam Roach  
 Field Vice President

**Disability Products**  
 Victor Herring  
 Field Vice President

**Life Insurance Products**  
 Alex Trout  
 Field Vice President

**Variable Products**  
 Teresa Cricket  
 Field Vice President

**PLANNING**  
 Henri Jay  
 Exec Vice President

**Capital Planning**  
 Bonnie Hawke  
 2nd VP, Planning

**Enterprise Risk Mgmt**  
 <open>  
 2nd VP, Planning

**Mergers & Acquisitions**  
 Gaston Deer  
 2nd VP, Planning

# Zolander Life Insurance Company

MEMORANDUM

July 2, 2004

TO New CFO

FROM Nicholas Sable, Human Resources, x123

RE Bonus Compensation

Our offer for the Chief Financial Officer position includes an annual salary of \$150,000 (earned and paid bi-weekly). In addition, as a member of the Senior Management Group (Vice President level and above), the CFO is eligible for the Executive Officer's Bonus Program. All employees may be able to participate in the Restricted Stock Option Program. Both are described below.

## **Executive Officer's Bonus Program**

The Bonus Program is targeted at 33.3% of annual salary for Senior Management Group members. The Bonus Program is based on a calendar year from January 1 to December 31. Performance will be evaluated at the end of the year. A bonus, if earned, will be paid by March 15 of the following year.

A precondition of the bonus payment is that the company maintains at least an "A" level rating (i.e. A- or better) from Kelly Ratings & Analysis. A 100% payout of the target amount occurs if three performance goals are met. For 2004, the performance goals are:

- New sales > \$500 million premium
- Gross investment return > 6%
- Assets under management > \$9,750 million

Each measure is given a one-third weighting in the bonus calculation. Prorated bonus amounts are paid for performance less than the applicable goals.

## **Restricted Stock Option Program**

All employees of Zolander Life are eligible to participate in the Stock Option Program if they have been employed with the company or its subsidiaries for six months and are not on performance warning (rating of 4 or lower) as of their latest review.

The performance year is the calendar year January 1 to December 31. Options are granted as of January 1 of the year following the performance year. One quarter of the options granted vest at the end of each year. Employees who terminate forfeit their rights to any unexercised options. In the case of retirement or total and permanent disability, the employee's outstanding options vest immediately at the end of the year of such retirement or disability.

Senior Management Group members are eligible for 5,000 restricted stock options per performance year. Other employees are eligible for 50 restricted options in a performance year.

# Zoolander Life Insurance Company

## Mission, Vision, Values and Ethics

### Mission

The mission of Zoolander Life is to be a high quality financial services company. To that end, we offer a range of insurance and financial services and products to meet the needs of our customers. We aim to provide the highest quality service to our customers. We maintain high ratings, financial strength and competitively priced products.

We respect our employees. We offer challenging career opportunities and personal development for all staff members. Our goal is to enable everyone to contribute to their fullest potential. We promote open and cooperative relationships among employees and customers.

In all that we do, we exemplify the highest standards of business ethics and personal integrity, and recognize our corporate obligation to the social and economic well-being of our community.

### Vision

The Company's vision is to seek a balance among our four operations: Fixed Annuities, Variable Annuities, Term Life Insurance, Disability Insurance. Each line will be responsible for at least 20% of our income. Our Annuity operations will offer outstanding investment performance. We seek to be an innovator in the Term Life Insurance field and the Disability Insurance arena. Consistent with Zoolander Life's "2010 Plan," our goal is to have \$5 Billion of Surplus by the year 2010.

### Values

We are in business to serve customers. Our goal is to establish long-term relationships; to that end, we endeavor to provide high quality customer service. We truly care about each person in our company. To be successful, we will treat others with the respect we desire for ourselves.

### Ethics

We conduct the Company's affairs in strict compliance with both the letter and the spirit of the law, and, at all times, will treat policyholders, customers, suppliers, and all others with whom the Company does business fairly and honestly. We recognize that our reputation is our most important asset. We will not compromise our integrity. Honesty and fair dealing are hallmarks of our business operations.

# Zoolander Life Insurance Company

MEMORANDUM

July 8, 2004

TO Charley Pigeon  
FROM Isabel Cougar, Planning, ext 641  
RE Financial Statements for the New CFO

I know you wanted financial statements for the past few years but this is the best I could find. (See the attachments.) We only have good data since our Demutualization; we didn't bother to convert all the old stuff. Also, last year was the first year that we introduced reporting by business segments. So, only 2003 is broken out by product line.

We are still struggling to complete the second quarter financial statements but they should be done soon.

Also, you asked about projections. We don't really do those at Zoolander Life...I'm not sure why. Bonnie Hawke from Planning did a real nice projection in support of our Demutualization work. It was a 5-year projection and covers the years 2000 thru 2004. She last updated it for actual 2001 results so now it covers years through 2006. That's probably good enough for your purposes. I expect that things have tracked pretty closely to the plan.

Attachments



# Zolander Life Insurance Company

## Balance Sheet

as of December 31, 2003

	Annuity	Disability	Life Ins	Variable	Corporate	Total
<b>Assets</b>						
Private Bonds						
Investment Grade	355.3	84.2	62.2	43.5	237.7	782.9
Below Investment Grade	575.6	29.5	16.4	16.0	113.3	750.8
subtotal	930.9	113.7	78.6	59.5	351.0	1,533.7
Public Bonds						
Investment Grade	2,315.2	335.6	221.2	184.4	229.1	3,285.5
Below Investment Grade	1,565.5	41.1	37.9	30.5	62.0	1,737.0
CMO (Investment Grade)	463.5	36.0	27.8	24.4	77.1	628.8
subtotal	4,344.2	412.7	286.9	239.3	368.2	5,651.3
Commercial Mortgages						
Investment Grade	613.1	80.1	59.1	54.1	102.4	908.8
Below Investment Grade	123.4	-	-	-	52.1	175.5
subtotal	736.5	80.1	59.1	54.1	154.5	1,084.3
Equities	-	-	-	-	-	-
Real Estate	647.9	28.0	8.7	22.6	135.5	842.7
Cash & Short Term Investments	5.2	1.1	0.8	3.0	26.1	36.2
Premiums Due and Unpaid	-	2.2	6.4	1.7	-	10.3
Deferred Acquisition Costs	0.5	1.8	10.4	3.6	-	16.3
Assets held in Separate Account	-	-	-	348.5	-	348.5
Other Assets	6.6	4.8	2.7	4.1	-	18.2
<b>Total Assets</b>	<b>6,671.8</b>	<b>644.4</b>	<b>453.6</b>	<b>736.4</b>	<b>1,035.3</b>	<b>9,541.5</b>
<b>Liabilities</b>						
Policy Liabilities - General Account	6,658.4	640.4	447.0	379.6	-	8,125.4
Other Liabilities - General Account	13.4	4.0	6.6	8.3	2.7	35.0
Separate Account Liabilities	-	-	-	348.5	-	348.5
<b>Total Liabilities</b>	<b>6,671.8</b>	<b>644.4</b>	<b>453.6</b>	<b>736.4</b>	<b>2.7</b>	<b>8,508.9</b>
Shareholder Equity	-	-	-	-	1,032.6	1,032.6
<b>Total Liabilities and Equity</b>	<b>6,671.8</b>	<b>644.4</b>	<b>453.6</b>	<b>736.4</b>	<b>1,035.3</b>	<b>9,541.5</b>

# Zolander Life Insurance Company

## Income Statement

for the year ended, December 31, 2003

	<b>Annuity</b>	<b>Disability</b>	<b>Life Ins</b>	<b>Variable</b>	<b>Corporate</b>	<b>Total</b>
<b>Revenues</b>						
Premiums	-	180.0	223.6	86.8	-	490.4
Investment Income	398.6	46.8	19.9	27.1	44.7	537.1
Total Revenue	<u>398.6</u>	<u>226.8</u>	<u>243.5</u>	<u>113.9</u>	<u>44.7</u>	<u>1,027.5</u>
<b>Expenses</b>						
Benefits	-	153.0	140.5	43.3	-	336.8
Surrenders	-	-	-	8.8	-	8.8
Increase in Reserves	-	42.3	47.0	36.5	-	125.8
Interest Credited	375.6	-	-	-	-	375.6
Commissions	-	12.3	22.2	6.5	-	41.0
Change in DAC	-	-	-	-	-	-
Other Expenses	8.6	22.2	10.1	2.4	3.1	46.4
Total Expenses	<u>384.2</u>	<u>229.8</u>	<u>219.8</u>	<u>97.5</u>	<u>3.1</u>	<u>934.4</u>
<b>Transfers to Separate Account</b>	-	-	-	(4.4)	-	(4.4)
<b>Income before Taxes</b>	14.4	(3.0)	23.7	20.8	41.6	97.5
Income Tax	6.8	(1.9)	4.4	10.2	13.4	32.9
<b>Net Income after Tax</b>	<u>7.6</u>	<u>(1.1)</u>	<u>19.3</u>	<u>10.6</u>	<u>28.2</u>	<u>64.6</u>

# Kelly Ratings & Analysis

1 Kelly Drive, Capital City

ph 123/555-6500

www.KellyR&A.com

June 23, 2004

A. Hugh Dodo, CFO  
Zoolander Life Insurance Co  
411 Main Street  
Zoo Falls 54321

Dear Hugh

Time once again for Kelly Ratings & Analysis' annual review of Zoolander Life. I will call you next week to set up a date. Ideally, Paula Silver, Director of our Financial Services Practice, and I would like to meet with Zoolander Life sometime in September. As in past years, we will come to your offices for a day of meetings with your senior management team. Figure on the presentation from Zoolander Life taking the first half of the meeting; the second half will be a free form Q&A with your management. We can finalize the agenda during next week's call.

I apologize that we did not meet with your company's management last year. However, let me assure you that Kelly's professional financial services analysts performed a through review of Zoolander Life utilizing publicly available information.

Attached is Kelly's rating rationale from last year. Please look through this document and make note of any changes you feel are necessary. In addition, we will need your 2003 financial information to be provided in the same format as in past years. I would like to receive that in advance of our meeting.

Also attached to this letter are descriptions of Kelly's Capital Adequacy formula, Kelly's Liquidity Ratio formula and the Kelly Ratio<sup>©</sup>. Of course, Kelly's analysts will calculate these factors for your company but we find that many of our clients wish to make their own calculations in advance of our formal analyst meeting.

I note that the Kelly Financial Wherewithal Rating<sup>™</sup> (commonly known as the "Kelly Ratio") for Zoolander Life is currently **A-** with a negative implication. It is rare for a company's rating to carry a negative implication for two years. We would like to resolve the issues surrounding the negative implication during this review cycle of Zoolander Life.

Sincerely

Otto Gold  
Director  
Financial Services Rating Bureau  
Ph 123/555-6534  
[OGold@KellyR&A.com](mailto:OGold@KellyR&A.com)

Cc Paula Silver, Kelly Ratings & Analysis

**When it comes to ratings, clearly you need Kelly**

## ZOOLANDER LIFE INSURANCE CO

411 Main St  
Zoo Falls 54321  
Ph 123/555-0000 Fax 123/555-0006

### Kelly Rating

Based on our opinion of the company's Financial Strength, it is assigned a Kelly Rating of A- (Super). The company's Financial Size Category is Class VIII.

### Rating Rationale

Rating Rationale: The rating for Zoolander Life reflects the company's strong capital position, fine operating performance and the long-term stability of its management. However, profitability has not been strong and Zoolander will face new challenges as a public company. Future sales remain a question mark.

### Five Year Rating History

Date	Kelly Rating
12/13/1971	A+
10/6/1980	A
9/22/2001	A-

### Business Review

Zoolander Life Insurance Company began operations in 1901. For most of its history, it has been controlled by the Lyon family. R. Thomas Lyon is its fourth generation leader. Earlier in 2002, Zoolander completed a demutualization and issued public stock. However, the Lyon family continues to exercise control through its 49% ownership.

Zoolander made its name selling innovative term life insurance at very aggressive rates. That continues to be a hallmark of the company today. The majority of the company's earnings come from the term life line of business.

The company's ventures outside of the term life insurance line have not been as profitable. Zoolander's Long-Term Disability line has yet to show consistent results. Variable annuities have been marginally successful and have helped the company reach a more affluent class of customers.

Zoolander's started its GIC business in the early 1980's and has managed it well. Investment operations have not performed as well and there is some concern if the low interest rate environment persists. However, the company has seen increasing income in this line over the past few years.

The GIC business is viewed as a nice complement to Zoolander's other businesses. The customers and the distribution system used to reach them is much different than used in the other lines of business.

With the demutualization earlier in 2002, Zoolander has set some very aggressive growth targets. The company appears to have the capital to fund this growth internally; however the plan to actually achieve sales at these levels remains unclear.

### Earnings

Zoolander's earnings have benefited over the years from investment income on its very strong capital position. We expect this source of earnings to decline in the future as the company attempts to grow its business in a very competitive market. The current lower interest rate environment will also put pressure on earnings.

Prior to its demutualization in 2002, the company did not break out results by business segment. The numbers attributable to those business segments for years prior to 2001 are approximate.

### Profitability Analysis (in millions of dollars)

	2002	2001	2000	1999
Net Op Gain				
Corporate	30.3	29.4	33.2	35.7
Annuities	13.1	9.8	8.8	6.0
Term Life	9.2	16.7	14.7	10.2
Disability	3.2	(4.4)	(1.2)	0.3
Variable Ann	2.1	1.9	6.5	3.7
Total	57.9	53.4	62.0	55.9

### Capitalization

Zoolander's capital and surplus at the end of 2002 totaled nearly \$1 billion (\$989.6 million). While the company continues to maintain a very strong capital position, the level of capital and surplus is not really comparable to prior years due to the demutualization in 2002.

We note that the company continues to operate without any long-term debt. While there is plenty of capital to fund available growth opportunities, Zoolander has stated that their desired capital structure would be 30% debt and that the company intends to achieve that mix in the future.

Such leverage could have a positive impact on the profile of Zoolander's future earnings. Management has stated that Zoolander's long-term cost of debt is approximately 5% and has remained almost constant at that level for many years.

**Sources of Capital Growth**  
(in millions of dollars)

Year	Net Gain	Cap Gains	Change AVR	Other Changes	Change in Cap & Surp
1999	55.9	1.2	(0.5)	1.0	57.6
2000	62.0	8.7	(0.3)	0.2	70.6
2001	53.4	(6.6)	(0.3)	(29.5)	17.0
2002	57.9	3.1	0.8	370.6	432.4

**Capital Trends**  
(in millions of dollars)

Year	Capital & Surplus	Stkhldr Divds	Policy Divds	AVR	IMR
1999	469.6	n/a	0.0	0.7	0.9
2000	540.2	n/a	0.0	0.4	0.9
2001	557.2	n/a	0.0	0.1	0.8
2002	989.6	22.2	0.0	0.9	1.2

**Investments and Liquidity**

Management anticipates lower investment returns in the near future due to the low interest rate environment. Default experience has been very good and can be viewed as much better than industry averages over the past five years.

Zoolander's liquidity position has been dropping over the past few years as they have increased their allocation of investments to longer-term non-investment grade bonds and real estate in order to boost yields.

**Liquidity Tests**  
(ratios except for Cash Flow)

Year	Operating Cash Flow	Quick Liquidity	Current Liquidity	Non-Invest Grade Bonds to Capital
1999	63.5M	61.6	209.9	1.0
2000	11.2M	33.1	189.9	2.2
2001	11.0M	35.0	185.4	2.5
2002	11.8M	27.0	173.4	3.0

**Investment Yields**  
(as a %)

Year	Net Yield	Mort- gages	Cash & Sh Trm	Inv Exp Ratio	
1999	6.90	6.88	7.66	5.02	8.88
2000	6.92	6.70	7.59	5.22	10.24
2001	6.78	6.66	7.60	4.87	7.25
2002	6.54	6.41	7.34	4.64	11.05

**Investment Data**  
(in millions of dollars)

current year distribution of bonds by maturity

	Years					yrs avg
	0-1	1-5	5-10	10-20	20+	
gov	...	0.9	0.3	.....	...	4
gov agency	...	0.1	1.7	0.5	0.8	13
pub util	...	0.7	1.9	...	.....	6
industrial	2.3	35.0	43.7	10.9	0.3	7
cap loans	...	0.2	0.3	0.3	.....	9
Total	2.3	36.9	47.9	11.7	1.1	7

	2002	2001	2000	1999
<u>Bonds (millions)</u>	152.5	134.1	119.3	105.2
gov	1.2	4.7	5.6	7.4
gov agency	3.2	1.7	1.9	2.1
pub util	2.6	6.2	8.4	6.8
industrial	92.1	86.3	82.2	81.4
cap loans	0.9	1.0	1.8	2.2
private	16.3	18.4	24.4	22.6
public	83.7	81.6	75.6	77.4

	2002	2001	2000	1999
<u>Bond Quality (%)</u>				
Class 1	63.9	70.6	73.1	79.6
Class 2	33.3	27.4	24.9	18.6
Class 3	1.1	1.3	2.0	1.8
Class 4	1.3	0.7	...	...
Class 5	.....	...	...	...
Class 6	0.4	0.1	...	...

	2002	2001	2000	1999
<u>Mortgages (millions)</u>	29.2	29.8	36.1	36.2
Commercial	100.0	100.0	100.0	100.0

	2002	2001	2000	1999
<u>Oth Inv Asts (millions)</u>	(1.2)	7.3	4.7	8.1
Cash	0.4	0.0	(0.6)	0.0
Short-Term	(0.2)	0.2	0.8	0.0
All Other	...	...	0.0	0.1

**History**  
Incorporated -- August 9, 1901

Originally formed as the Zoolander Friends Assessment Society in 1901. Purchased by the forerunner to Lyon Enterprises in 1904. Changed to a legal reserve Mutual life insurance company in 1919. In 2002 converted to a stock insurance company through an IPO and took on the current name. Fully 49% of the stock is held or controlled by Lyon Enterprises.

### **Officers**

Chairman of the Board, President, CEO and COO R. Tomas Lyon, IV; Executive VP-Planning, Henri Jay; Sr VP & Chief Counsel, Kate Finch; Sr VP-Administration, Odette Bird; VP-CFO, A. Hugh Dodo; VP-CMO, Danielle Wolfe; Field VPs, Sam Roach, Teresa Cricket, Victor Herring, Alex Trout

### **Directors**

Hermine Dauphin, Jeanne Z. Holstein, R. Tomas Lyon IV, Karl Palomino, Ivan X. Salmon

### **Reinsurance**

Zoolander Life utilizes a YRT reinsurance agreement with Rose Reinsurance for their Term Life Insurance business. In addition, Zoolander has excess coverage through Rose Reinsurance on their disability business.

### **Regulatory**

An examination of the financial condition was made as of December 31, 2001 by the state insurance department. An annual, independent, audit of the company is conducted by the accounting firm of Brown & Company.

**Territory:** Zoolander Life is licensed in all states except New York.

**Kelly Ratings & Analysis**  
**Insurance Enterprise Liquidity Standards**  
formula effective January 1, 2002

**Rating Standards**

<b>Liquidity Ratio</b>	<b>Rating Level</b>
> 250	A+ (Superior)
217 to 249	A (Robust)
182 to 216	A- (Stable)
144 to 181	B+ (Fair)
100 to 143	B (Troubled)

The Kelly Ratings & Analysis Liquidity Standards require that available assets be compared to potential liabilities under two alternate scenarios of liquidity need. The results of these two scenarios are averaged to determine the Kelly Liquidity Rating.

The first scenarios is a "Crash Scenario" where the organization is assumed to face an immediate need for liquidity. The second scenarios is labeled a "Bleeding Scenario" to represent a situation where the organization may face increased withdrawals or depressed asset values over a several month period.

Available Assets are determined by applying the Kelly asset availability factors to the statutory assets of the organization. These Kelly availability factors have been developed through the study of asset values over many years, including periods with both increasing and declining markets.

Potential Liabilities are developed by applying Kelly liability demand factors to the obligations found on the organization's statutory financial statements. These factors have been created from years of study of liability benefit patterns under many different situations. They do include non-economic withdrawals.

A simple ratio of Available Assets to Potential Liabilities is utilized in the Kelly Liquidity Ratio calculations. The final value may be adjusted up or down 5% to reflect either superior or deficient operating characteristics.

**Kelly Ratings & Analysis**  
**Insurance Enterprise Liquidity Factors**  
 formula effective January 1, 2002

**Asset Availability Factors**

	Crash Scenario	Bleeding Scenario
<b>Asset Types</b>		
Cash	100%	100%
Short-Term Investments	100%	100%
Agency MBS	90%	90%
CMOs - Sequentials	80%	80%
CMOs - Z Tranches	0%	50%
Other CMOs	0%	0%
NAIC "1" CMBS	90%	90%
NAIC "2" CMBS	75%	90%
NAIC "1" Public Corporate Bonds	98%	100%
NAIC "2" Public Corporate Bonds	96%	100%
NAIC "1" 144A Private Placements	80%	90%
NAIC "2" 144A Private Placements	65%	75%
NAIC "1" Non-144A Private Placements	70%	80%
NAIC "2" Non-144A Private Placements	40%	50%
NAIC "3" Public Corporate Bonds	0%	25%
NAIC "3" 144A Private Placements	0%	20%
Asset Backed Securities	90%	90%
Other Non-Investment Grade Bonds	0%	0%
Unaffiliated Public Investment Grade Pref Stock	100%	100%
Unaffiliated Public Common Stock	70%	85%
Assets in Securities Lending Programs - Collateralized	100%	100%
Assets in Securities Lending Programs - Otherwise	70%	100%
Funds Withheld Reinsurance Assets	0%	0%



**Kelly Ratings & Analysis**  
**Insurance Enterprise Liquidity Factors**  
 formula effective January 1, 2002

**Liability Demand Factors**

	Crash Scenario	Bleeding Scenario
<b>Liability Risk Factors</b>		
Traditional Life	35%	50%
Term Life	50%	50%
Interest-Sensitive Life	50%	50%
Deferred Annuities	90%	100%
Single Premium Immediate Annuities	100%	100%
Other Individual Annuities	100%	100%
Variable Life	30%	50%
Variable Annuities	0%	0%
Individual Accident & Health	50%	50%
Individual Disability	50%	50%
Structured Settlements	100%	100%
GICs & Funding Agreements	100%	100%
Group Annuities	100%	100%
Other Deposit Funds	90%	90%
Group Accident & Health	50%	50%
Group Life	50%	50%
Group Disability	50%	50%
Health Claim Reserves	100%	100%
<b>Surrenderability Factor</b>		
No Surrenders Allowed	0%	0%
Market-Value Adjustment	45%	45%
Surrender Charges > or = 5%	60%	60%
Surrender Charges < 5%	90%	90%
No Surrender Charges	100%	100%

# Kelly Ratings & Analysis

## Kelly Ratio

revised July 1, 2002

### Rating Standards

<b>Kelly Ratio</b>	<b>Rating Level</b>
> 250%	A+ (Outstanding)
201% to 250%	A (Impressive)
151% to 200%	A- (Leading)
126% to 150%	B+ (Adequate)
100% to 125%	B (Fair)
< 100%	C (Marginal)

Kelly Ratings & Analysis developed the Kelly Ratio to measure the financial strength of an organization based on a normalized measure of its earnings.

For each year, the ratio of pre-tax earnings to adjusted earnings needs is calculated. The Kelly Ratio takes the weighted average of this ratio for the past four years. The weightings are one-fifth per year for the prior three years except for the most current year which is given a weighting of two-fifths.

Adjusted Earnings Needs are calculated as the reserves times the applicable haircut.

<b>Reserve</b>	<b>Haircut</b>
Individual Life	0.75%
Group Life	0.45%
Annuities	0.60%
Health	1.00%
Variable Products	0.45%
ASO equivalent premiums	0.20%
Other	1.25%

**Kelly Ratings & Analysis**  
**Insurance Enterprise Capital Requirements**  
 formula effective January 1, 2003

Required Capital = [square root of {C-2<sup>2</sup> + (C-1 + C-3)<sup>2</sup>}] + C4

Kelly Capital Ratio = (Actual Capital & Surplus)/Required Capital

	Base	Investment grade	Non- investment grade
<b>C-1 (Asset Default) Risk</b> <span style="float: right;">(as a % of asset value)</span>			
Private Bonds		1.0%	7.5%
Public Bonds		0.2%	5.0%
CMOs		0.2%	5.0%
Commercial Mortgages		3.0%	6.0%
Stock - equities	30.0%		
- affiliates	% owned x affiliate's RBC		
Real Estate	10.0%		
Cash and Short Term	0.3%		
Other assets	0.1%		

<b>C-2 (Underwriting) Risk</b>			
Life Insurance - Term	0.2%	% of net amount at risk	
Life Insurance - Whole Life	0.7%	% of net amount at risk	
Health Insurance - Individual	20.0%	% of premiums	
Health Insurance - Group	15.0%	% of premiums	
Disability Insurance	25.0%	% of premiums	
Disability Insurance	5.0%	% of reserves	

<b>C-3 (Interest Rate) Risk</b>			
Life Insurance	0.50%	% of reserves	
Health Insurance	0.25%	% of reserves	
GICs - all maturities	1.25%	% of reserves	
Annuities - all other	5.00%	% of reserves	

<b>C-4 (General Business) Risk</b>			
Life & Health Insurance	1.50%	% of premiums	
Variable Products	0.50%	% sep acct liab	

**Ana Lamb**

---

**From:** "Larry McCaw" McCawL@zlic.com  
**To:** "All Employees" <mail list zlicEEs@zlic.com>  
**Sent:** Monday, July 19, 2004 11:28 AM  
**Subject:** Founder's Day Celebration

Zoolander Life will celebrate Founder's Day this year on Friday, August 13, 2004. In honor of the 104<sup>th</sup> anniversary of our founding, employees are encouraged to wear jeans to work on that day. In addition, we will have the traditional Founder's Day picnic. Back again this year by popular demand, we will have a bear wrestling demonstration and carnival games.

While this is always a fun time, the Founder's Day Committee would like to take this opportunity to remind everyone of our company's long and colorful history. After all, there is a reason we celebrate Founder's Day.

---

Noah Zoolander, pioneer, business mogul and town founder established the Zoolander Friends Assessment Society in 1901. His belief was that even the common man had a right to insure his life for a fair price. Zoolander served as the first president of the company which bore his name. Ironically, Noah Zoolander lost the company in the Banking Panic of '04 when it was taken over by Lyon & Sons (now known as Lyon Enterprises).

R.T. Lyon briefly served as the second President (1904) until passing on those responsibilities to his son Richard (Rich) Lyon, Jr. Under Rich Lyon's leadership (1904-19), the company grew to insure over 1,000 people and converted from an assessment society to a legal reserve mutual life insurance company. Unfortunately, Rich Lyon died of influenza in the spring of 1919. His policy was the first paid out under the new legal structure and it nearly caused the company to fail.

Now known as the Zoolander Life Insurance Society, the company then passed to R.M. (Trip) Lyon, III. Trip Lyon's tenure at the company (1919-1949) was mostly uneventful. In 1949, the Presidency of the company was handed to Trip Lyon's 24-year old son, R. Tomas Lyon, IV who continues to run the company today.

Tomas Lyon has been an innovator and champion in the insurance industry. He eliminated the Home Service Life Insurance division in the 1950's and was one of the first to offer Term Insurance in a big way with the innovative "Life Term" policy. A Property & Casualty subsidiary (Zoolander Car & Dwelling) was opened in 1976 and subsequently closed in 1988. In the early 1980's the company was one of the pioneers of Guaranteed Investment Contracts (GICs). Lyon also led the company's charge into Variable Life insurance in 1989. Lyon shepherded the company to conversion from a mutual insurer to a public company with a massive IPO in February 2002. He is also responsible for the successful acquisition and integration of the Select Hazardous Occupation Company (SHOC Inc.) last year.

In a little over 100 years, Noah Zoolander's experiment of offering the common man a little life insurance to pay for final expenses has evolved into the insurance and financial services giant we know today. Remember at Zoolander Life.....It's your Life™!

Larry McCaw  
Chair, Founder's Day Committee  
Company Historian  
Sr. Records Tech – Section AH  
Ext #752

# Brown & Company Accountants, PLC

80 Centre Street, Suite 1300  
Capital City 54301  
Ph 123/555-9900

June 15, 2004

A Hugh Dodo, CFO  
Zoolander Life Insurance Co  
411 Main Street  
Zoo Falls 54321

Dear Hugh

Thank you for allowing us to present our Independent Accountant's Report at the May 18, 2004 meeting of the Audit Committee of the Board of Directors. We thought that many of the questions were very insightful. Of course, it helps that all of the members of the Audit Committee are either current or former CFOs of financial service businesses. At the next meeting, we will present some information that Mr. Palomino requested with respect to the general level of cash disbursement controls that we see at our other audit clients.

It seems like the Annual Statement planning cycle never ends. We would like to get started on the work for 2004. First, of course, is reappointment of our firm as Zoolander Life's Independent Auditors by your Board of Directors. We hope that is a mere formality given our 10-year association with your company but we take nothing for granted. In today's environment of accounting scandal, we believe our firm is head and shoulders above the rest on integrity. We would be happy to make a presentation of our credentials at your next Audit Committee or Board of Directors meeting.

Secondly, we would like to schedule our kick-off meeting with you and your staff for some time in late September. There will be a new Senior on your account; Nicole Gray has to rotate off after working with Zoolander Life for the past three years. We will have some refinements to our work schedule. Many of the work papers and data items will be identical to last year. We plan to be in your office during December to look at the September 30 numbers. Since we began that practice in 2000, it has streamlined our review and saves us valuable time in January and February.

Once we set the date for the kick-off meeting, we can work on an agenda. Any new accounting issues at Zoolander Life would certainly be a major discussion topic.

Yours truly,

Lisa White, CPA  
Partner  
Brown & Company Accountants, PLC  
Ph 123/555-9903  
Fax 123/555-9910

Matthew Black, Jr., CPA  
Partner  
Brown & Company Accountants, PLC  
Ph 123/555-9904  
Fax 123/555-9910

**A Hugh Dodo**

---

**From:** "Pigeon, Charley" [PigeoChar@zlic.com](mailto:PigeoChar@zlic.com)  
**To:** "Dodo, Hugh" [DodoA@zlic.com](mailto:DodoA@zlic.com)  
**Sent:** Friday, June 18, 2004 7:46 AM  
**Subject:** Appointment of Brown & Company

Due to the timing, I think we can do this without a formal Audit Committee or Board meeting.

I talked to Mr. Lyon this morning. Since he and the other two members of our Audit Committee (Karl Palomino and his wife, Jeanne Holstein-Palomino) are together in Tuscany, they discussed reappointing Brown & Co as Independent Accountants for next year. That was approved.

Mr. Lyon will decide if he wants it on the agenda of the September 13 Board meeting and what documents he wants to share with the Board before they officially approve it. You can proceed as you have planned.

**Charley Pigeon**  
Board Secretary

----- Original Message -----

**From:** 'Dodo, Hugh' [DodoA@zlic.com](mailto:DodoA@zlic.com)  
**To:** 'Pigeon, Charley' [PigeoChar@zlic.com](mailto:PigeoChar@zlic.com)  
**Sent:** Wednesday, June 16, 2004 4:23 PM  
**Subject:** Appointment of Brown & Company

Just got a letter from Lisa White and Matthew Black at Brown & Company. They mentioned that the Audit Committee (or Board of Directors) needs to formally appoint them for work on the 2004 audit. We plan to get started on the 2004 audit in September.

I'd recommend Brown & Company again this year. We have had a long relationship with them and their fees are quite reasonable. The fact that they know Zoolander Life so well saves us a lot of time and money compared to using someone new.

Could you add an agenda item on to the next Audit Committee/Board of Directors meeting appointing Brown & Company as Independent Auditors?

Hugh  
ext-666

# Zoolander Life Insurance Company

MEMORANDUM

July 2, 2004

TO New CFO

FROM R. Tomas Lyon, IV

RE Financial Goals for 2005

As you are aware we are starting Zoolander's strategic planning for 2005. It is important that we have the right goals as we attempt to drive higher levels of performance in our organization.

I would like to re-emphasize my expectation that the corporation earn a 15% return on equity. Now that we are in the public markets, I hear from analysts on an almost weekly basis that our return on equity numbers are too low. Our cost of equity capital is approximately 11%. To be earning less than this cost is simply unacceptable.

The key is going to be earnings improvement in every line of business. Our results in 2003 were not great. The net income goals for 2004 seem reasonable: Annuities \$10.0 million, Variable \$20 million, Life Ins \$30 million, Corporate \$40 million and break-even in Disability. I believe we will achieve those goals; but we need to aim higher.

I have confidence that we can achieve a 15% return on equity for Zoolander Life. I look forward to discussing these points further with you in a couple of months.

# Zoolander Life Insurance Company

MEMORANDUM

January 15, 2004

TO Hugh Dodo

FROM Sean Basset

RE 2004 MARKETING PLAN

We have completed the final round of pricing for our 2004 line of products. You will be pleased to learn that we have seemingly managed to increase our profit margin projections over prior years. Furthermore, Danielle Wolfe has forwarded the marketing area's resulting production amounts to me, and they are anticipating a full 50% increase in production over prior years.

Table 1 below shows the Zoolander Index of Pricing ("ZIP") and Danielle's 2004 production by line of business. As a reminder, the ZIP is calculated as the present value of profits divided by the present value of premium at issue. The present value of profits have been calculated using this year's corporate discount rate of 9%.

---

**TABLE 1**

**Projected 2004 New Business**

---

<b>Line of Business</b>	<b>ZIP</b>	<b>2004 Premium (\$Millions)</b>
Fixed Annuity	5.1%	130
Disability	6.1%	105
Life Insurance	8.6%	25
Variable Annuity	3.6%	190

---

I will be sending a full pricing memorandum early next week.



**A Hugh Dodo**

---

**From:** "Foxy, Wanda" FoxxW@zlic.com  
**To:** "Dodo, Hugh" DodoA@zlic.com  
**Sent:** Wednesday, June 16, 2004 4:23 PM  
**Subject:** Reinsurance Problem

Well, the good news is that we have our reinsurance for the rest of this year. The bad news is that it looks like Rose Reinsurance isn't going to be in this market next year. We have plenty of time before we need to look around for coverage; however, if we are going to consider changing the parameters, Actuarial will need some lead time to run experience studies.

I have some ideas I'd like to share with you at our monthly meeting in July.

**Wanda**

x-345

----- Original Message -----

**From:** 'Richard Scarlet'  
**To:** 'Wanda Foxx'  
**Sent:** Monday, June 14, 2004 8:27 AM  
**Subject:** Zoolander Life 2004 Reinsurance Program

Just got it in the mail, Rose Reinsurance has agreed to renew your coverage for another six months, effective 7-1-2004. Here's the specifics...

Term Life Reinsurance – Yearly Renewable Term. 6-month incurral period, 12-month reporting period. \$1 million letter of credit required. Cost \$0.030/\$1,000. Ceded \$75 billion face amount of insurance from 12-31-2003; We'll update for June 30 numbers when they are available.

Disability Reinsurance – Excess Coverage – reinsurer takes amounts in excess of \$4,000 of monthly benefit up to your monthly maximum benefit of \$8,000. Cost is 4% of premium per year. Refund eligible, 75% of the amount calculated by subtracting claims from premium. Deficit carry forward from prior years, \$38,475.

However, Rose Re has decided to get out of the life reinsurance business to concentrate on their more lucrative P&C reinsurance lines. We'll need to shop this coverage for a January 1, 2005 effective date. Might be a good time to reconsider your reinsurance options.

Richard Scarlet  
Lilac Intermediaries  
Ph 123/555-4567  
Fax 123/555-4550  
[R-Scarlet@lilac.com](mailto:R-Scarlet@lilac.com)

The information in this email is confidential and may be privileged. It is intended solely for the addressee. If the reader of this message is not the intended recipient, any disclosure, copying, distribution or action taken or omitted to be taken in reliance on it is prohibited. If you have received this communication in error, please notify us immediately by replying to the message or by telephoning 123/555-4500 and deleting it from your computer.

**A Hugh Dodo**

---

**From:** "Bird, Odette" [BirdO@zlic.com](mailto:BirdO@zlic.com)  
**To:** "Dodo, A Hugh" [DodoA@zlic.com](mailto:DodoA@zlic.com)  
**Sent:** Monday, June 17, 2004 4:18 PM  
**Subject:** 3P Project – cost overruns

You told me to warn you when the Periodic Payment Processing (Triple P) Project blew through its budget. That has indeed happened. I got the latest bill from Green Software Solutions for software development. Through June 15 we have total project costs of \$803,472. As you recall the budget for the entire project was only \$800,000.

There is no way we'll be able to begin using the system on September 1 (the original target date). Shary Tan from Green Software Solutions estimates they will need two more months of programming time for Phase I, the payment module. We would need another month of in-house testing after that. They have not even started on Phase II, the interface with the accounting/financial reporting system.

I think we need to get the project team together to discuss where we go from here. I believe we have four options:

1. We can revise the target date and continue with the project. I believe we could make December 1. I would estimate future costs of \$248,000 broken out into \$112,000 for Green Software to complete the Phase I programming, \$20,000 for our testing of Phase I and \$116,000 for programming and testing of Phase II.
2. We could omit Phase II of the project. Not having the accounting interface would change some of our initial assumptions about the savings from the Triple P Project. I would have to keep one full-time person to do the accounting work. So instead of reducing staffing in the payment area by 12, we would eliminate 11 positions. I believe we were estimating the cost of a position at \$80,000 including salary, benefits, etc.
3. We could delay the project into next year in order to allocate money in the 2005 budget. I don't think that would change our testing costs or anything on Phase II. Might make Phase I more expensive by \$15,000 as Green Software would need to re-start the project after being away from it for several months.
4. We could pay overtime and an incentive bonus to get the project done within the original timeframe. Shary Tan from Green Software said that if we were willing to pick-up the overtime and pay a bonus to her programmers (approximately \$50,000 total), she would get both Phase I and Phase II done by the end of July. It feels like extortion but, under the right conditions, it might be worth pursuing.

I suppose I'll get dinged on the next "Budget vs. Actual" report for this project. However, I am technically still under budget because we included \$15,000 per employee of termination costs in the budget. If we decide not to finish the system, I'll keep the people and not have to pay the termination costs.

**Odette**

**R. Tomas Lyon**

---

**From:** "Rick, James" RickJ@IMRJB.com  
**To:** "Lyon, Tomas" LyonT@zlic.com  
**Cc:** "Murfee, Chuck" MurfC@IMRJB.com  
**Sent:** Friday, April 2, 2004 4:32 PM  
**Subject:** Summary of Appraisal Analysis

Tomas—

We are very sorry to hear that your plans to explore a sale of Zoolander have changed. Fortunately, we had only just completed our analysis of the inforce business and found that this business is worth \$145 million at a discount rate of 9%.

As you have requested, I am having Charlie Murfee prepare a report summarizing our analysis thus far. We will look forward to starting this appraisal back up for you in the future.

**Jimmy**  
Managing Partner  
IMRJB Consultants, LLC

----- Original Message -----

**From:** 'Lyon, Tomas'  
**To:** 'Rick, James'  
**Sent:** Wednesday, March 31, 2004 1:32 PM  
**Subject:** STOP WORK IMMEDIATELY

Jim—

Negotiations have unfortunately broken off, and we have decided not to pursue the sale of Zoolander at this time. We have appreciated your assistance with the appraisal and would appreciate a report of your findings thus far. Please discontinue any further analyses at this time.

I'm off to the golf course and will be back in the office tomorrow afternoon.

Tommy  
ext-346

# Zoolander Life Insurance Company

MEMORANDUM

August 5, 2004

TO Department Heads  
FROM Henri Jay, Planning, ext 663  
RE Enterprise Risk Management – Introducing Bill Buck

Please join me in welcoming Bill Buck to the Zoolander Life team.

Bill will be starting in the Planning department on August 9 and he will report to me. His position will be Second Vice President – ERM. As you can tell by his title, he will be leading our efforts to bring Enterprise Risk Management to Zoolander Life.

Bill is trained as an actuary. He received his FSA in 1999. For the last six years, he worked for NADA Life where he was in charge of their Insurance Planning department. It is in that role where he was exposed to Enterprise Risk Management. He developed the first ERM models for NADA Life. Bill has been a speaker on the topic of ERM at several Society of Actuaries meetings. He has an undergraduate degree in Mathematics from State University and spent the first 5 years of his career in various actuarial positions at Zest Life Insurance.

In a couple of weeks, after Bill has gotten settled, I would like to introduce him to you and your staff. Perhaps the best forum for that would be at your department's staff meetings (if you have one) where Bill could spend 10-15 minutes describing Enterprise Risk Management. I anticipate that Bill will be working very closely with you and some of your staff members over the next several months as we bring ERM to Zoolander Life.

Later this fall, Bill will be putting together an internal seminar on Enterprise Risk Management. We will also be setting up an ERM council. It is not too early to start thinking about who from your staff would participate.

I thank you in advance for giving Bill your full cooperation as we implement Enterprise Risk Management at Zoolander Life.

**Charley Pigeon**

---

**From:** "Lyon, Tomas" [LyonT@zlic.com](mailto:LyonT@zlic.com)  
**To:** "Pigeon, Charley" [PigeoChar@zlic.com](mailto:PigeoChar@zlic.com)  
**Sent:** Monday, June 21, 2004 9:21 AM  
**Subject:** New Product Approval

Charley, make sure the new CFO gets this when he starts and tell him to take care of it.

Thanks/RLT

**From:** "Wolfe, Danielle" [WolfeD@zlic.com](mailto:WolfeD@zlic.com)  
**To:** "Lyon, Tomas" [LyonT@zlic.com](mailto:LyonT@zlic.com)  
**Sent:** Friday, June 18, 2004 6:06 PM  
**Subject:** New Product Approval

RT, Kate Finch wants to hold up our new product until there is further clarification on the new regulations. The product team of myself, Teresa Cricket and Sam Roach, have been meeting over the last two months and now this last minute barrier is thrown in front of us. Sure, every detail hasn't been worked out yet, but we always manage to figure things out. If we waited for everything to be perfect, my sales force would never have any products to sell. Business is about taking risks. This is our opportunity to lead the market and ensure that we meet our sales target for the year. If we are not the first company out with the product we won't have a chance.

I have already ordered the marketing materials and they should arrive in time for us to hit the streets by September 1. All I need is your approval. Let's not miss this opportunity. I have never seen my salesmen so excited. Of course the increased commission scale has something to do with it but they want to make Zoolander a company the public will not forget.

**From:** "Finch, Kate" [FinchK@zlic.com](mailto:FinchK@zlic.com)  
**To:** "Wolfe, Danielle" [WolfeD@zlic.com](mailto:WolfeD@zlic.com)  
**Sent:** Friday, June 18, 2004 12:34 PM  
**Subject:** New Product Approval

I finished reviewing the new regulations of the Enhanced Savings Annuity (ESA). I still have some concerns about Teresa's interpretation of the tax treatment that will be afforded our proposed new product under these regulations. The regulations are very complex and do not seem to apply to all purchasers of this product. In some instances, due to the purchasers unique set of circumstances the tax favorable treatment does not apply. I suggest holding off on the launch of this product until we can get clarification.

**Kate**