

Spring 2011

EXAM AFE

**Advanced Finance and
Enterprise Risk Management**

CASE STUDY

AFE morning

Advanced Finance/ERM

Case Study

Spring 2011

Zolander Life

It's your life!

From the desk of
R. Tomas Lyon, IV

April 16, 2010

Re New CFO

Congratulations. You will 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. You should be finding this memo at the top of the collection that he has created for you. If there's anything else you need, please don't hesitate to ask him.

This job will be a real test. I am counting on you to learn quickly and to make decisions that will take our company to the next level.

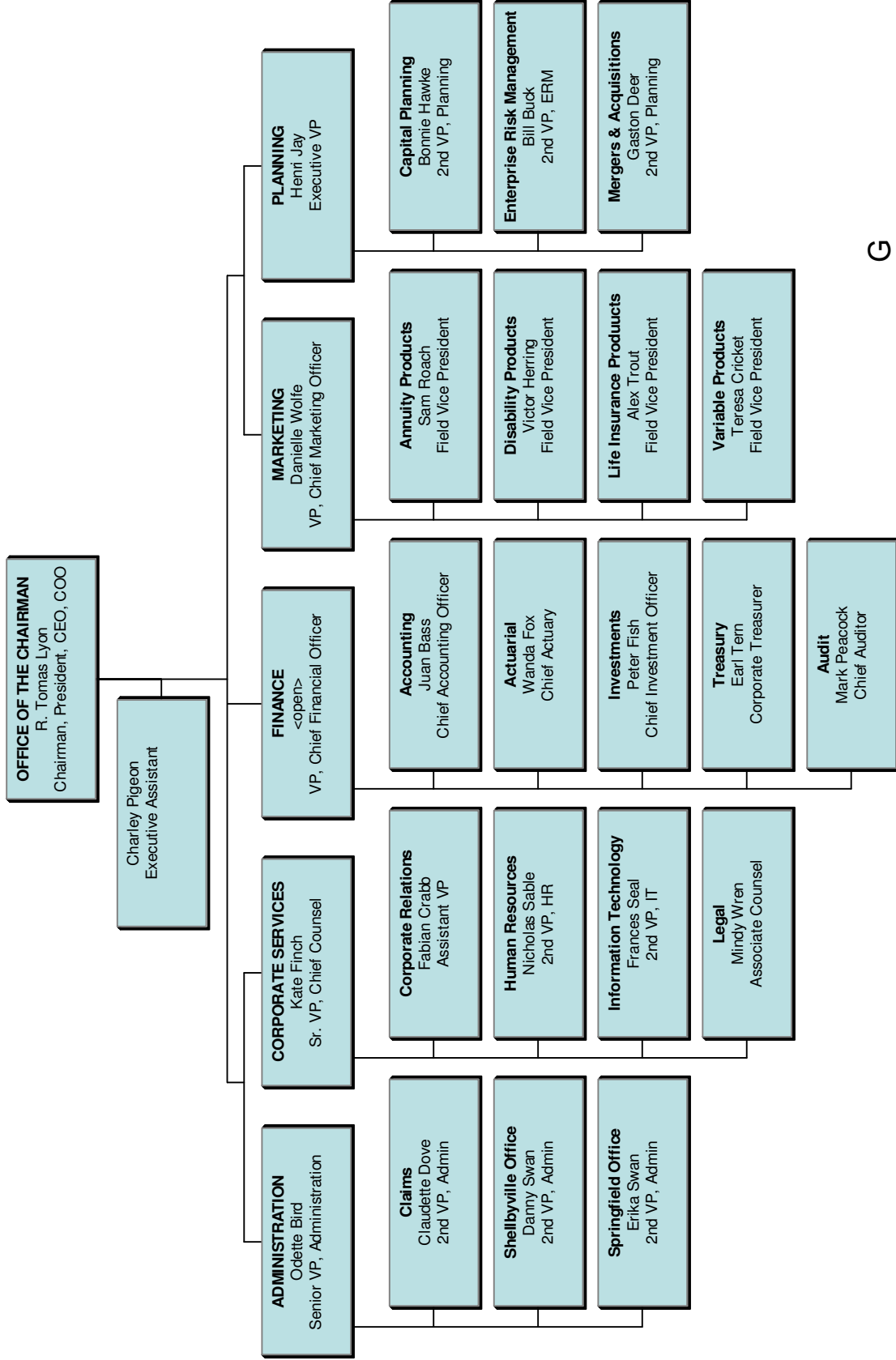
Very Sincerely

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

Cc Charley Pigeon

Zoolander Life Insurance Company

as of March 19, 2010



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: GICs, Variable Annuities, Term Life Insurance, and 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.

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, we 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.

Excerpts from Zoolander Life Proxy Statement – Dated March 11, 2010

Board of Directors – Biographies

R. Tomas Lyon IV – Chairman, President, CEO, and COO. Age 69. Term Expires September 2010.

Karl Palomino – Former CFO, Zoolander Life (retired September 2008). Age 62. Term began September 2008, term expires September 2012.

Jeanne Holstein-Palomino – Philanthropist, former administrative assistant, Zoolander Life. Age 30. Term began September 2008, term expires September 2012.

Ivan X. Salmon – former Chief Legal Counsel, Zoolander Life (retired September 2008). Age 58. Term began September 2008, term expires September 2012.

Hermine Dauphin – former accounting partner for Dollars ‘R Us, former insurance regulator for Insurance Department of Illinois. Age 52. Term began September 2008, term expires September 2010.

2009 Compensation

1. Board of Directors

<u>Board Member</u>	<u>Basic Cash Payment</u>	<u>Basic Stock Payment</u>	<u>Committee Work</u> ¹	<u>Other Compensation</u> ²
Lyon	\$100,000	\$50,000	\$40,000	\$ 50,000
Palomino	75,000	25,000	40,000	250,000
Holstein-Palomino	75,000	25,000	40,000	125,000
Salmon	75,000	25,000	40,000	125,000
Dauphin	75,000	25,000	40,000	5,000

¹Committee Work represents \$20,000 for chairperson of any committee and \$10,000 for non-chair position on any committee.

² Other Compensation represents compensation awarded by Compensation Committee for extra services performed by members, including use of company transportation, access to legal and accounting services, and bonus cash awards.

Stock Ownership of Board Members

The following list details the value of stock awards and year awarded for each current Board member. Board members did not report owning any additional shares of Zoolander stock.

<u>Board Member</u>	<u>2008</u> ³	<u>2009</u> ⁴
Lyon	\$30,000,000	\$10,000,000
Palomino	20,000,000	5,000,000
Holstein-Palomino	10,000,000	3,000,000
Salmon	10,000,000	3,000,000
Dauphin	-----	-----

³ 2008 stock award represents employee awards granted upon completion of IPO.

⁴ 2009 stock award represents special bonus to key executives and Board members

2. Compensation of Key Executives

<u>Executive</u>	<u>Year</u>	<u>Salary</u>	<u>Bonus</u>	<u>Value of Stock Awards</u> ⁵
Lyon	2009	\$4,000,000	\$667,000	\$10,000,000
	2008	1,500,000	1,500,000	30,000,000
	2007	1,000,000	333,000	-----
Dodo	2009	\$1,500,000	\$200,000	\$7,500,000
	2008	350,000	150,000	500,000
	2007	225,000	82,000	-----
Finch	2009	\$600,000	\$200,000	\$2,000,000
	2008	270,000	90,000	-----
	2007	210,000	70,000	-----
Jay	2009	\$450,000	\$150,000	\$1,000,000
	2008	210,000	70,000	-----
	2007	180,000	60,000	-----

⁵ Stock Awards include both employee and Board Member awards

All Stock awards made in 2008 and 2009 vested immediately upon grant of award.

Board of Directors Committees

		COMMITTEES				
Board Member	Audit	Compensation	Nomination	Investment	Risk Management	
Lyon	M		C	M		
Palomino	C	M			M	
Holstein-Palomino	M	C			M	
Salmon		M	M	C		
Dauphin			M	M	C	
Meetings Held	1	1	1	0	4	

C = Chairperson

M = Member

Selected Excerpts from Meetings held in 2009

Report of Committees

1. Audit Committee – Mr. Lyon reported that the committee met once. The committee had voted to reappoint Brown & Co as Independent Accountants for 2010. This recommendation was approved unanimously by the full Board.

Mr. Lyon expressed appreciation for the Board’s support of the long-standing, strong relationship with Brown & Co., since it allowed Zoolander to spend less money and streamline the audit process.

The committee also reviewed a report from Mr. Dodo outlining the status of Zoolander’s system of internal controls. Mr. Lyon suggested that Mr. Dodo’s report focused too much on potential risks and too little on audit. Lyon noted that risk evaluation was the purview of the Risk Management committee. Further, Lyon, preferred that Mr. Dodo focus more effort on audit staff training in order to prevent the possibility of fraud in the processing of paychecks and travel reimbursements.

The committee also received Mark Peacock’s audit reports for the current and prior quarters.

2. Compensation Committee – Ms. Holstein-Palomino reported that at its annual meeting the committee submitted recommendations for increased compensation and performance awards to Mr. Lyon, who approved them.
3. Nominating Committee – Mr. Lyon reported that the nominating committee voted to recommend a continuation of the current Board structure (5 members with at least one independent member). Mr. Lyon noted that Ms. Dauphin recommended expanding the Board with a larger portion of independent members; this recommendation was defeated 2 to 1. The Committee also recommended that Mr. Salmon begin a search of candidates to replace Ms. Dauphin, whose term expires

next year. It is contemplated that Mr. Lyon will be re-nominated in 2010. The recommendations were approved by the full Board by a vote of 4 to 1.

4. Investment Committee – Mr. Salmon reported that due to numerous calendar conflicts, this committee did not meet during the year.
5. Risk Management Committee – Ms. Dauphin reported that the committee met on a regular quarterly basis during the year. Meetings focused on reports and interviews with key employees in finance, systems, and audit. As a result of their investigation, a number of risk management concerns were discovered and the committee unanimously recommended the creation of an Enterprise Risk Management Officer.

During the debate of this recommendation with the full Board, Mr. Lyon expressed relief that this committee would not be needed in the future once the ERM Officer came on board. He also wanted to ensure that the position reported to someone with a lot of experience who knew the company well and could serve as a guide to the ERM Officer, helping him/her gather information from various areas within the company. The new ERM Officer should be able to prepare any reports needed by external audiences with respect to risk.

Ms. Dauphin brought up the subject of what would happen to the concerns that the Risk Management Committee had brought to light if the Committee were disbanded. Mr. Lyon responded that they would be forwarded to the new ERM Officer. He decided that Henri Jay would be the right person for the new ERM Officer to report to. Once the new ERM Officer formulated recommendations from this input, he would deliver them to Mr. Jay, who would pass them on to the manager of the area or areas involved.

The full Board voted 4 to 1 in favor of Mr. Lyon's recommendations.

Charley Pigeon

From: "Larry McCaw" McCawL@zlic.com
To: "All Employees" <mail list zlicEEs@zlic.com>
Sent: Monday, March 15, 2010 11:28 AM
Subject: Founder's Day Celebration

Zoolander Life will celebrate Founder's Day this year on Friday, June 11, 2010. In honor of the 106th 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 1904. 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 '05 when it was taken over by Lyon & Sons (now known as Lyon Enterprises).

R.T. Lyon served as the second President (1905-1915) until passing on those responsibilities to his son Richard (Rich) Lyon, Jr. Under Rich Lyon's leadership (1915-1929), the company grew to insure over 1,000 people and converted from an assessment society to a legal reserve mutual life insurance company. In October of 1929, Rich Lyon died under mysterious circumstances; 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 (1929-1965) was mostly uneventful. In 1965, 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 late 1960'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 1977 and subsequently closed in 1989. 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 annuities in 1990. Lyon shepherded the company to conversion from a mutual insurer to a public company with a successful IPO in February 2008, whereby ownership was widely diversified amongst numerous investors.

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

Zoolander Life Insurance Company

MEMORANDUM

February 16, 2009

TO Department Heads

FROM Peter Fish

RE Derivative Team

I'm very excited to announce that John Badger has agreed to join Zoolander Life, reporting to me in the newly created role of Head Derivatives Trader and Director of Derivative Securities Administration. He will be charged with building a derivatives team at Zoolander to deal with trading and administration.

We managed to scoop this derivatives hotshot from the Crimson Sardine Hedge Fund that recently wound down operations. John is very keen on the opportunity to put his own leading-edge derivative pricing model to work developing innovative derivative strategies in the more collegial and autonomous environment offered here at Zoolander.

Our investment team to date has lacked sophisticated derivatives skills. With John on board, not only will we be able to dynamically hedge our current VA product, but he can also help the pricing actuaries work out all those fancy GM-ABCs they are considering for the new VA product. Even beyond this, in John's capable hands we'll be able to leverage the derivatives desk and generate excess earnings turning this into a profit center on its own!

As of now, John will be a one-man show, but plans to hire a couple of derivatives traders within a few months, if we can get more budget dollars allocated to this initiative.

One of the ways that we can manage to establish this operation with minimal staff is that John has developed some rules of thumb that he uses to estimate credit-risk exposure. This saves having to bother with time-consuming modeling of this risk.

He also has developed good contacts in the industry so he is used to being able to informally set up an agreement with a trading partner each time a new type of trade is transacted. No matter how many positions we may have with a certain counterparty, each new deal has its own quirks and he likes to start fresh, without being constrained by the past. John has several years of experience in this market, so Zoolander will be the beneficiary of his established relationships.

We're going to let John be the front man for a while, since he's the one with the relationships, even though he is going to keep in constant contact with senior management so that he doesn't get us into any deals that are bigger than we really want.

For now, we plan to say as little as possible publicly about these activities since we are still fleshing out all the operating parameters we do not want too much scrutiny before we feel that we are really ready for it, and things have become somewhat stabilized.

I see a very profitable future ahead!

Zoolander Life Insurance Company

MEMORANDUM

April 14, 2010

TO New CFO

FROM Peter Fish

RE Hedge Fund Initiative

I'm very excited to present our Hedge Fund initiative for your approval. Until now the activities of our head derivatives trader, John Badger, at Zoolander have been limited to hedging Zoolander's own risks. This initiative puts Zoolander's resources to use in a new way.

We are seeking seed capital to launch a new hedge fund into the marketplace, Zoolander's first, targeting high net worth individuals. John has built a proprietary model using what he has labeled: "volatility arbitrage strategy". Basically, the model can determine when the market has mispriced the volatility of complex derivatives. We can take advantage of those mispricings, and close our positions for profit when the market valuations catch up.

It is also important to note that John has agreed to manage the fund under tight delta limits, utilizing a dynamic hedging strategy derived from his model. We don't have to worry about administration as John's model can mark the fund's positions to market daily. John has thoroughly reviewed and tested his model. He can demonstrate that his model has consistently produced lower prices than where the market traded on some particular derivative.

Another advantage we plan to capitalize on is John's philosophy of not purchasing credit enhancements or any other related risk-reduction arrangements, as he considers them to be a waste of money.

John has forwarded his model assumptions to Bill Buck for his review. He also provided Bill with a walk-through of his model's calculations using a straight-forward interest rate swap. I am sure this will get Bill comfortable with this initiative.

Once we get this project launched, not only will we get our huge management fees, we will get great returns on as much seed capital as you want participating in this great strategy!

Zoolander Life Insurance Company

MEMORANDUM

April 2, 2010

TO Charley Pigeon

FROM Isabel Cougar, Planning, ext 641

RE Financial Statements for the New CFO

Per your request for financial statements for the past few years, I've been able to get these year-end 2009 financial statements for each product line. I received input from Wanda Fox regarding the asset allocation to each block, and this is reflected within these statements.

Although I didn't have prior historical statements readily available to pass along, I believe Wanda has a copy of the Kelly Ratings report for us. This report should provide various asset and product line financial trends over the past few years, as I'm assuming this is what you're after in your request for historical info. Simply drop her an E-mail and request a copy.

Attachments:

2009 Income Statement by LOB

2009 Balance Sheet by LOB

Zoolander Life Insurance Company

Statutory Income Statement

for the year ended, December 31, 2009

(\$ millions)

	GIC	Disability Insurance	Term Life Ins	Variable Annuity	Corporate	Total
Revenues						
Premiums	-	180.0	223.6	56.8	-	460.4
Investment Income	398.6	46.8	19.9	30.4	44.7	540.4
Total Revenue	398.6	226.8	243.5	87.2	44.7	1,000.8
Expenses						
Death/LTD Benefits	-	153.0	140.5	55.9	-	349.4
Surrenders & Partial W/D	-	-	-	186.4	-	186.4
Increase in Reserves	-	42.3	57.0	9.3	-	108.6
Interest Credited	375.6	-	-	-	-	375.6
Commissions	-	12.3	22.2	6.5	-	41.0
Other Expenses	8.6	22.2	10.1	2.4	9.1	52.4
Total Expenses	384.2	229.8	229.8	260.5	9.1	1,113.4
Transfers to Separate Account	-	-	-	(177.9)	-	(177.9)
Income before Taxes	14.4	(3.0)	13.7	4.5	35.6	65.2
Income Tax	5.0	(1.1)	4.8	1.6	12.5	22.8
Net Income after Tax	9.4	(2.0)	8.9	2.9	23.1	42.4

Zolander Life Insurance Company
Statutory Balance Sheet
as of December 31, 2009
(\$ millions)

	GIC	Disability Insurance	Term Life Ins	Variable Annuity	Corporate	Total
Assets						
Private Bonds						
Investment Grade	607.7	55.8	120.8	52.9	220.6	1,057.9
Below Investment Grade	329.5	3.0	19.4	19.5	104.4	475.8
subtotal	937.3	58.8	140.2	72.4	325.0	1,533.7
Public Bonds						
Investment Grade	3,427.7	454.8	144.2	204.3	161.1	4,392.1
Below Investment Grade	486.2	31.9	20.1	37.1	41.7	617.0
CMO (Investment Grade)	466.7	16.7	49.4	29.7	66.3	628.8
subtotal	4,380.6	503.4	213.7	291.1	269.1	5,657.9
Commercial Mortgages						
Investment Grade	617.3	81.6	62.6	65.8	81.5	908.8
Below Investment Grade	124.2	-	-	-	51.3	175.5
subtotal	741.6	81.6	62.6	65.8	132.8	1,084.3
Equities and Equity Derivatives	-	-	-	20.0	-	20.0
Real Estate	652.3	2.5	42.2	27.5	118.1	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
Assets held in Separate Account	-	-	-	3,348.5	-	3,348.5
Other Assets	-	4.8	2.7	4.1	-	11.6
Total Assets	6,717.0	654.4	468.6	3,834.1	871.1	12,545.2
Liabilities						
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	-	-	-	3,348.5	-	3,348.5
Total Liabilities	6,671.8	644.4	453.6	3,736.4	2.7	11,508.9
Shareholder Equity *	45.2	10.0	15.0	97.7	868.4	1,036.3
Total Liabilities and Equity	6,717.0	654.4	468.6	3,834.1	871.1	12,545.2

* represents required capital for each line of business; remaining capital is shown in the Corporate line

Kelly Ratings & Analysis

1 Kelly Drive, Capital City

ph 123/555-6500

www.KellyR&A.com

February 10, 2010

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 early April. As in past years, we will come to your offices for a day of meetings with your senior management team. Count 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 thorough 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 2009 financial information to be provided in the same format as in past years. I would like to receive that in advance of our meeting.

I note that the Kelly Financial Wherewithal Rating™ (commonly known as the "Kelly Rating") 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.

I have also attached new, proposed Kelly Liquidity Standards. In light of the current economic conditions, our quantitative modeling group recommended a revision to our methodology. We will now use the lower of the liquidity ratio calculated on the going-concern scenario and the ratio calculated under the 3-month stress scenario. Since liquidity analysis has been a major focus during company interviews this year I wanted to give you a peak at what is to come. As you know, the liquidity standards are an important component of the overall Kelly rating process.

Sincerely

Otto Gold
Director
Financial Services Rating Bureau
Ph 123/555-6534
OGold@KellyR&A.com

Cc Paula Silver, Kelly Ratings & Analysis

When it comes to ratings, clearly you need Kelly

Kelly Ratings & Analysis

Insurance Enterprise Liquidity

Liquidity Rating Standards

proposed

Rating Level	Liquidity Ratio
A+ (Superior)	>260%
A (Robust)	220%-259%
A- (Stable)	180%-219%
B+ (Fair)	140%-179%
B (Troubled)*	<140%

Kelly 's liquidity model measures an insurer's liquidity ratio under both a going-concern scenario and a 3-month stress scenario, with the lower of the two used for ratings purposes.

Achieving the liquidity standard does not automatically imply qualification for a particular rating level.

Rating levels corresponding to liquidity standards are general guidelines to be used in conjunction with the full Kelly rating process.

*The "<140%" ratio corresponds to all ratings below investment grade, not just the "B" rating.

ZOOLANDER LIFE INSURANCE CO

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

Kelly Financial Wherewithal Rating™

Based on our opinion of the company's financial strength, it is assigned a **Kelly Financial Wherewithal 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.

Rating History

Date	Kelly Rating
12/12/1974	A+
10/5/1983	A
9/21/2008	A-

Business Review

Zoolander Life Insurance Company began operations in 1904. For most of its history, it has been controlled by the Lyon family. R. Tomas Lyon is its fourth generation leader. Earlier in 2008, Zoolander completed a demutualization and issued public stock.

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 Disability Insurance 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 Guaranteed Investment Contracts (GIC) business in the early 1980's and has generally 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 are much different than those for the other lines of business.

With the demutualization earlier in 2008, 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 low interest rate environment will also continue to put pressure on earnings.

Prior to its demutualization in 2008, the company did not break out results by business segment. The numbers attributable to those business segments for years prior to 2008 below are approximate.

Profitability Analysis (in millions of dollars)

Net Op Gain	2008	2007	2006	2005
Corporate	30.3	29.4	33.2	35.7
GIC	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 2008 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 2008.

We note that the company continues to operate without any long-term debt. While there is capital to fund available growth opportunities, Zoolander has stated that their desired long term capital structure would be 30% debt. However, at this time there are no immediate plans to reach this target structure in the near future.

Sources of Capital Growth (in millions of dollars)

Year	Net Gain	Cap Gains	Change AVR	Other Changes	Change in Cap & Surp
2005	55.9	1.2	(0.5)	1.0	57.6
2006	62.0	8.7	(0.3)	0.2	70.6
2007	53.4	(6.6)	(0.3)	(29.5)	17.0
2008	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
2005	469.6	n/a	0.0	0.7	0.9
2006	540.2	n/a	0.0	0.4	0.9
2007	557.2	n/a	0.0	0.1	0.8
2008	989.6	22.2	0.0	0.9	1.2

Investments and Liquidity

Default experience in the fixed income portfolio 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.

Investment Yields (as a %)

Year	Net Yield	Bonds	Mortgages	Cash & Sh Trm	Inv Exp Ratio
2005	6.90	6.88	7.66	5.02	8.88
2006	6.92	6.70	7.59	5.22	10.24
2007	6.78	6.66	7.60	4.87	7.25
2008	6.54	6.41	7.34	4.64	11.05

Investment Data (in millions of dollars)

2008 distribution of bonds by maturity

	Years					yrs avg
	0-1	1-5	5-10	10-20	20+	
(% allocation)						
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

	2008	2007	2006	2005
<u>Bonds (Bil)</u>	6.9	6.1	5.3	4.4
(% allocation)				
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

	2008	2007	2006	2005
<u>Bond Quality (%)</u>				
Class 1	67.9	70.6	73.1	79.6
Class 2	21.3	22.3	24.9	18.6
Class 3	7.1	4.3	2.0	1.8
Class 4	2.3	1.7	.....	.....
Class 5	.....	.....	.....	.....
Class 6	1.4	1.1	.....	.....

	2008	2007	2006	2005
<u>Mortgage and RE (Bil)</u>				
Mortgages	1.1	1.0	0.9	0.8
Real Estate	0.8	0.7	0.7	0.6

	2008	2007	2006	2005
<u>Other Assets (Mil)</u>	76.2	73.5	66.6	70.0
Cash & Short-Term	32.4	30.0	28.6	27.7
Equity & Derivatives	20.2	18.2	18.8	20.0
All Other	23.6	25.3	20.2	22.3

History Incorporated -- August 8, 1904

Originally formed as the Zoolander Friends Assessment Society in 1904. Purchased by the forerunner to Lyon Enterprises in 1905. Changed to a legal reserve Mutual life insurance company in 1929. In 2008 converted to a stock insurance company through an IPO and took on the current name.

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 facultative support with Rose Reinsurance for their Term Life Insurance business. In addition, Zoolander has coinsurance coverage through Rose Reinsurance on their disability business.

Regulatory

An examination of the financial condition was made as of December 31, 2007 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.

Zoolander Life Insurance Company

400 Main Street – Zoo Falls 54321

April 6, 2010

Mr. Otto Gold
Director
Financial Services Rating Bureau
Kelly Ratings & Analysis
1 Kelly Drive, Capital City

Dear Otto:

It was good to see you and Paula again last week. We certainly had a thorough discussion! I was a little surprised, though, at how much importance you seemed to place this year on processes and procedures. Our presentation was focused almost exclusively numbers because I have always felt that numbers drive results.

I am taking this opportunity to address a few of the topics you raised at the meeting for which either we did not have a sufficiently organized response, or you did not seem to understand or appreciate the response that we offered.

Asset/Liability Management

I am very proud of the work we have done in this area. We have had our processes in place for some time now.

For interest sensitive liabilities we monitor Macaulay duration, which is a well-established measurement at Zoolander. Within each of these blocks of business, we periodically measure the duration of the assets and liabilities. If these measures begin to drift apart, we rebalance our asset portfolio such that its new duration approaches that of the liabilities. The liability duration is measured as part of our semi-annual cash flow testing exercises. This immunization approach has worked in the past.

As mentioned during your visit, John Badger manages our hedging for the VA GMDB. He is our Head Derivatives Trader and reports directly to Peter Fish. John came from the Crimson Sardine Hedge Fund recently, and is helping us avoid losses on our GMDB guarantees. He uses an ad hoc approach based on In-The-Money (ITM) and CTE measures from a stochastic analysis of the guarantee. His extensive experience working in the hedge fund business has made his ad hoc approach not only effective from a loss perspective, but also cost-effective.

Zoolander has long term goals of moving to a more systematic approach, especially with our new VA Plus product, which has guaranteed living benefits, as well as death benefits. This long term plan involves utilizing liability portfolio characteristics, such as delta, gamma, vega and rho. However, John Badger does not have a timeline for this methodology change at this time.

Internal Control

We have a very strong audit department, reporting to our CFO. These people have years of experience in detecting possible fraudulent claims and other such problems. In fact, we have

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one staff member who was a pioneer in systems auditing. He works very closely with our IT department and makes sure he knows what is going on throughout our systems. Each quarter, Mark Peacock prepares a report for the Audit Committee of the Board. This report shows all exceptions to control limits that occurred in the past quarter. It also lists any audits performed on company processes that occurred during the past quarter.

Compliance is handled within the product/pricing area. As part of their research into developing a product, the pricing actuaries are expected to ensure that their products comply with current regulations. Additionally, Wanda Fox, our chief actuary, keeps up to date on any regulatory trends on the horizon, such as Fair Value. If any of these new concepts were implemented for regulatory or accounting purposes, Wanda would direct her staff accordingly for future pricing and financial reporting.

As I explained at the meeting, we have an ERM officer now, Bill Buck. He has set up a Risk Management committee to gather information on what is happening around the company. When he and his committee detect any risks that they feel should be of concern, Bill creates a documentation memo about it for his boss, Henri Jay. If Henri feels that Bill's recommendation has merit, he will forward it to the manager of the department involved.

We have a great Board of Directors, a group of people who are used to each other and who communicate with each other regularly, both professionally and socially. Because of this closeness, the Board rarely has disagreements and our meetings go smoothly. I am very proud of the job the Board has done, and I'm proud to be a part of it.

The CFO reports to us at each Board meeting about what is going on within the company. As I mentioned before, numbers drive results, so I believe it is critically important that the Board hear from and interact with our CFO on a regular basis. Over the years, we have developed detailed financial metrics that the CFO uses to lead those Board discussions

As I mentioned, I was surprised with your questions concerning processes and procedures. I noted your concerns that Senior Management does not take an active role in enforcing the company's policies and procedures and that there is no documentation of a plan in place to achieve the company's strategic goals. Mark Peacock's exceptional audit team reviews all business processes on a regular basis. I am planning on having Mark start sharing his Board report with the senior management team to help make senior leaders more aware of their role in ensuring the company complies with documented procedures in the future.

I hope this gives you an organized view of the internal controls and demonstrates to you that things go smoothly at Zoolander.

Management of Specified Risks

Credit Risk – Although we don't have quantitative targets, we are comfortable with our current credit profile, and Peter Fish and his Investments team are very good about not straying too far away from this credit allocation. When I followed-up with them after our meeting, they reminded me that they also watch concentration to both corporate entities and industry sectors. Wanda Fox, our chief actuary, is also cognizant of the concentration of counterparty risk with reinsurers, which was included in the material we presented to you.

ALM and Market Risk Control – I already covered our ALM process above, but in addition, I would just like to mention how well Wanda Fox and Peter Fish work together in sharing information to make this work. The ALM activities are formally in Wanda's area but she is very dependent, of course, on Peter's cooperation to get everything to come together. At the end of each year, we close that year's block of new investments and liabilities and Wanda prepares a report showing

how the durations have been matched. She also takes a look at the prior years' blocks and lets Peter know if any of them have strayed too far with respect to the difference between total assets and total liabilities. If they have diverged too much, she lets Peter know and she makes sure that he transfers the appropriate assets to get the balances evened up. Also, before he left, Hugh Dodo wrote his proposal for liquidity risk management. He was very comprehensive and detail-oriented when it came to analyzing new things. All the top financial management has a copy of that proposal to use in case of any liquidity problems.

Operational Risk – As I explained in our meeting, here again we really benefit from our strong team and the fact that they have been working together for so long. Our new ERM officer is taking care of working with the various departments to gather up everyone's ideas about risk and sort them out into a report. He will be able to share this throughout Zoolander's management and, of course, we will be happy to share it with Kelly Ratings. As I mentioned above, we have a strong audit team, including one person with a special focus on IT security issues.

Economic Capital

I found our discussion on different types of financial reporting systems to be very enlightening, as well as challenging! The message I took away was that the outside world's expectations are growing that we will build our own Economic Capital model tailored to our own particular risks, rather than relying on statutory and regulatory formula-based capital requirements to determine whether the company is financially strong enough.

As I mentioned at the meeting, Wanda Fox has been providing updates from time to time on the changes going on in Europe and Canada, and new concepts that are gaining acceptance, such as Fair Value and Economic Capital. You will be happy to know that earlier today I sent her a memo instructing her to get started on planning the implementation of Economic Capital at Zoolander.

I hope this additional information helps you get more comfortable with the processes here at Zoolander. Please let me know if I can be of any further help.

Sincerely,

R. Tomas Lyon, IV
Chairman, President, CEO and COO

Zoolander Life Insurance Company

MEMORANDUM

February 22, 2010

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 March 1 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 2004. 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 over the next several months as we bring ERM to Zoolander Life.

In a couple of months, Bill will put 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.

Zoolander Life Insurance Company

MEMORANDUM

April 13, 2010

TO New CFO

FROM Henri Jay

RE Liquidity Risk

I am forwarding to you a memo I just received from Bill Buck, Second Vice President—ERM. I think that Bill's concerns are valid and that liquidity is an important issue for the new CFO to address.

Bill and I are happy to provide ideas and do footwork to support related projects, but when it comes to getting the right people to hear just the right words at just the right time, well, we are smart enough to look for just the right people to do it.

Hugh Dodo had attempted to get this ball rolling once before, but all that remains of that attempt is a rough draft of Hugh's initial ideas, which Tomas distributed to various executives, but has never discussed with anyone, including Hugh.

Would you be willing to provide some bullet points for a memo to the Board, describing liquidity risk and recommending methods of managing it? Perhaps if we make sure we are focusing our communication on the key items, and we work together to figure out the who and when, we can get things moving in a positive direction.

Welcome aboard!

Zoolander Life Insurance Company

MEMORANDUM

March 26, 2010

TO Henri Jay
FROM Bill Buck
RE Liquidity Risk

Henri, during my survey of Zoolander's key risks, I have become particularly concerned about liquidity risk. I have a feeling I am not the only one. I think that our liquidity conditions is one of the issues Kelly has with Zoolander, that has resulted in the "negative implication" on our A-rating with them. The liquidity test numbers show a decreasing trend over the past few years.

I need to account for liquidity in the ERM model I am building. As I consider the balance sheet as of December 31, 2009, I would like to make sure I have a good grasp of Zoolander's liquidity ratios. Are they currently calculated? If so, how are they defined?

I realize that the balance sheet looks just fine and that most people would say that there are enough assets to cover all liabilities. But what if current market conditions were to worsen and trigger a run-on-the-bank scenario?

From: "Otter, Samuel" otters@zlic.com
To: "Fox, Wanda" foxw@zlic.com
Cc: "Pigeon, Charles" pigeonc@zlic.com
Re: Inforce Projections for the Term Life and Disability Insurance Blocks
Date: March 11, 2010

Wanda,

I wanted to follow up on your voicemail from last week. I am not sure what you'll be using these for, but please find attached projections for the term life and disability insurance inforce blocks. The projected results start from the actual 2009 financials, so I think that they should provide a good starting point for whatever it is you are doing. I have attached the details for the deterministic projection of cash flows based on our current best estimate assumptions, using the current yield curve scenario for asset cash flows.

When I realized you needed the assets to be run as well as the liabilities, I sensitivity-tested the asset composition using a variety of starting sub-portfolios of assets allocated to the term line, before I finally settled on a starting asset portfolio recommended by Peter Fish. I was surprised to find the results were rather insensitive to starting portfolio composition, as long as the starting portfolio was reasonably constructed. For now I am operating under the assumption that the starting portfolio composition is an equally minor factor with respect to the disability insurance block.

You had mentioned using conservative experience assumptions, but I will need more direction on what this means. Similarly, you had mentioned that these projections would be used for reserving purposes. We should discuss this further as well. The results I am providing for term life assume that both stat and tax reserves are computed using the current XXX CRVM reserving methodology. For the disability insurance block, the disabled life reserves are based on 1985 Commissioners Individual Disability Table A (CIDA), 4%.

Sam Otter, ASA

Attachment:

Projected Cash Flows for Term Life Insurance LOB

Prepared by Sam Otter (ext. 7890)

Cash Surrender Value: 22.3 PV after-tax income on capital 2.6
 Statutory Reserve: 453.6 PV capital release 11.0
 Required Capital 12/31/2009 15.0 earnings rate on capital 9%
 PV After-Tax Income 12/31/2009 48.2 discount rate 9%

	Actual 2009	Projections -->									
		2010	2011	2012	2013	2014	2015	2016	2017	2018	
Premiums (Net of Reinsurance)	223.6	207.9	197.8	189.3	182.1	176.6	181.0	171.4	159.7	148.5	
Net Investment Income	19.9	22.6	19.9	19.3	18.6	18.0	18.0	18.1	17.7	17.1	
Commissions & Acquisition Expenses	22.2	7.4	4.0	2.8	2.3	1.8	1.6	1.3	1.0	0.8	
Maintenance Expenses	10.1	9.5	8.8	8.3	7.8	7.4	6.9	6.6	6.2	5.8	
Benefits (Net of Reinsurance)	140.5	191.0	222.0	237.3	241.5	238.1	228.0	221.2	215.4	212.4	
Change in Reserves (CRVM)	57.0	9.6	(29.6)	(40.1)	(51.0)	(58.2)	(54.3)	(60.9)	(68.5)	(77.9)	
Pre-Tax Income	13.7	13.0	12.5	0.3	0.1	5.5	16.8	21.3	23.3	24.5	
Taxes	4.8	4.6	4.4	0.1	0.0	1.9	5.9	7.5	8.2	8.6	
After-Tax Income	8.9	8.5	8.1	0.2	0.1	3.6	10.9	13.8	15.1	15.9	
Weighted Treasury Yield	4.86%	4.86%	4.86%	4.86%	4.86%	4.86%	4.86%	4.86%	4.86%	4.86%	
Portfolio Yield	4.69%	4.69%	4.69%	4.69%	4.69%	4.69%	4.69%	4.69%	4.69%	4.69%	

From: "Otter, Samuel" otters@zlic.com
To: "Fox, Wanda" foxw@zlic.com
Cc: "Pigeon, Charles" pigeonc@zlic.com
Re: Assumption Changes on Term Life and Disability Insurance Blocks
Date: March 31, 2010

Wanda,

We are in the process of reviewing and updating our best estimate assumptions on all blocks. Since you had requested projections earlier this month for the Term Life and Disability Insurance blocks, I wanted to keep you informed of potential changes to the assumptions used in those projections. These assumption changes will impact future cash flows and profits on these blocks.

Below is a summary of the assumption changes for each block. These changes will flow through all of our projections going forward and will impact our Embedded Value results accordingly.

Term Life Assumption Changes

- i.) Statutory required capital for the block should be 20% lower than currently assumed as a result of a recent change in regulation.
- ii.) Pre-tax asset yield should be 25bps higher than currently assumed as a result of the revised asset allocation for the portfolio.

Disability Insurance Assumption Changes

- i.) Capital requirement on the block should be 35% higher than currently assumed
- ii.) Maintenance Expenses should be 10% higher than currently assumed

Sam Otter, ASA

Zoolander Life Insurance Company

MEMORANDUM

April 15, 2010

TO New CFO

FROM Wanda Fox

RE Risk Adjusted Pricing

The Actuarial Pricing team has just completed the development of a new Term Insurance Portfolio. This represents the first time that Zoolander has priced using risk adjusted measures (one of the components of the new strategic risk management process.)

As a result of the new risk adjusted measures, prices needed to increase for the longer duration Term plans. While this was justified based on the results of the pricing analysis, I am concerned that Term Insurance is now on an unlevel playing field vis-à-vis our other products since none of Zoolander's other products are priced using risk adjusted measures.

I would like to set up some time to discuss this further with you. I look forward to your thoughts on this issue.

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MEMORANDUM

March 15, 2010

To: "Dodo, Hugh" DodoH@zlic.com
Cc: "Fish, Peter" FishP@zlic.com; "Fox, Wanda" WandaFox@zlic.com
From: "Badger, John" BadgerJ@zlic.com
Subject: Fwd: Hedging and Option Data

Hugh,

Thank-you for your interest in my hedging program for the GMDB on the old VA products. I took an approach that hedges big risks, but avoids unnecessary costs, while transitioning from the actuarial risk management approach originally used at Zoolander for this benefit. I think it is pretty straightforward, but please don't hesitate to let me know if you have any questions.

The actuarial approach to managing the risk for the old VA GMDB, as you probably know, used the GMDB liability present value at the CTE(95) level, and invested this amount of funds in risk-free bonds. To transition the old VA to my new, dynamic hedging program, I wait until the current risk profile suggests it is cost-effective to do so. Currently, Wanda's actuarial area sends me a quarterly report tracking individual policy CTE(95) levels, that compares the current level to the CTE(95) level that was used to develop the actuarial hedge at issue. Once the current requirement exceeds the initial level by 10% or more, I transition from the actuarial approach and move the policy to my dynamic hedging program.

The following table shows the option valuations and details you asked for - I've provided both puts and calls. To keep it simple, I've assumed management charges are zero. These valuations are based on the classic Black-Scholes formulae that you may be familiar with, and I've included them below. The beauty of these formulae is that they also indicate how to construct a hedge portfolio that replicates the option, so I've added this additional breakdown of the option cost to the table. I think it will help you understand the hedging strategy further. Please let me know if there is any notation that you are unfamiliar with.

Black-Scholes formulae used:

$$P_t = Ke^{-r(T-t)} \Phi(-d_2) - S_t \Phi(-d_1)$$

$$C_t = S_t \Phi(d_1) - Ke^{-r(T-t)} \Phi(d_2)$$

$$\text{Where, } d_1 = [\ln(S_0/K) + (r + \sigma^2/2)(T - t)] / [\sigma \sqrt{t(T-t)}] \\ d_2 = d_1 - \sigma \sqrt{t(T-t)}$$

I have provided 1-year, 2-year and 3-year options, all at the same strike level, but relative to various index levels. I have shown sample interim values as the options age to maturity. Please let me know if you would like to see different tenors or index levels.

Zoolander Life Insurance Company

Puts

T	t	K	S_t	σ^2	r	(T-t)	d_1	$N(-d_1)$	d_2	$N(-d_2)$	Equity	Bond	Hedge Cost
1	0	100	100	0.04	0.03	1	0.2500	0.4013	0.0500	0.4801	-40.129	46.587	6.458
1	0	100	95	0.04	0.03	1	-	-	-	-	-	-	-
1	0	100	105	0.04	0.03	1	0.0065	0.5026	-0.2065	0.5818	-47.745	56.459	8.714
2	0	100	100	0.04	0.03	2	0.4940	0.3107	0.2940	0.3844	-32.620	37.304	4.683
2	0	100	95	0.04	0.03	2	0.3536	0.3618	0.0707	0.4718	-36.184	44.434	8.250
2	0	100	105	0.04	0.03	2	0.1722	0.4316	-0.1106	0.5440	-41.006	51.237	10.231
3	0	100	100	0.04	0.03	3	0.5261	0.2994	0.2432	0.4039	-31.440	38.040	6.600
3	0	100	95	0.04	0.03	3	0.4330	0.3325	0.0866	0.4655	-33.250	42.543	9.293
3	0	100	105	0.04	0.03	3	0.2849	0.3878	-0.0615	0.5245	-36.845	47.936	11.091
3	0	100	105	0.04	0.03	3	0.5739	0.2830	0.2274	0.4100	-29.718	37.475	7.756
2	1	100	100	0.04	0.03	1	0.2500	0.4013	0.0500	0.4801	-40.129	46.587	6.458
2	1	100	90	0.04	0.03	1	-	-	-	-	-	-	-
2	1	100	110	0.04	0.03	1	0.2768	0.6090	-0.4768	0.6832	-54.813	66.306	11.492
3	1	100	100	0.04	0.03	2	0.7266	0.2338	0.5266	0.2993	-25.713	29.041	3.328
3	1	100	100	0.04	0.03	2	0.3536	0.3618	0.0707	0.4718	-36.184	44.434	8.250
3	1	100	90	0.04	0.03	2	-	-	-	-	-	-	-
3	1	100	110	0.04	0.03	2	0.0190	0.5076	-0.3018	0.6186	-45.680	58.257	12.577
3	1	100	110	0.04	0.03	2	0.6905	0.2449	0.4077	0.3418	-26.942	32.185	5.243
3	2	100	100	0.04	0.03	1	0.2500	0.4013	0.0500	0.4801	-40.129	46.587	6.458
3	2	100	80	0.04	0.03	1	-	-	-	-	-	-	-
3	2	100	120	0.04	0.03	1	0.8657	0.8067	-1.0657	0.8567	-64.534	83.140	18.606
3	2	100	120	0.04	0.03	1	1.1616	0.1227	0.9616	0.1681	-14.724	16.315	1.592

Calls

T	t	K	S_t	σ^2	r	(T-t)	d_1	$N(d_1)$	d_2	$N(-d_2)$	Equity	Bond	Hedge Cost
1	0	100	100	0.04	0.03	1	0.2500	0.5987	0.0500	0.5199	59.871	-50.457	9.413
1	0	100	95	0.04	0.03	1	-	-	-	-	-	-	-
1	0	100	105	0.04	0.03	1	0.0065	0.4974	-0.2065	0.4182	47.255	-40.585	6.670
2	0	100	100	0.04	0.03	2	0.4940	0.6893	0.2940	0.6156	72.380	-59.741	12.639
2	0	100	95	0.04	0.03	2	0.3536	0.6382	0.0707	0.5282	63.816	-49.743	14.074
2	0	100	105	0.04	0.03	2	0.1722	0.5684	-0.1106	0.4560	53.994	-42.940	11.054
3	0	100	100	0.04	0.03	3	0.5261	0.7006	0.2432	0.5961	73.560	-56.137	17.424
3	0	100	95	0.04	0.03	3	0.4330	0.6675	0.0866	0.5345	66.750	-48.850	17.900
3	0	100	105	0.04	0.03	3	0.2849	0.6122	-0.0615	0.4755	58.155	-43.457	14.698
3	0	100	105	0.04	0.03	3	0.5739	0.7170	0.2274	0.5900	75.282	-53.918	21.363
2	1	100	100	0.04	0.03	1	0.2500	0.5987	0.0500	0.5199	59.871	-50.457	9.413
2	1	100	90	0.04	0.03	1	-	-	-	-	-	-	-
2	1	100	110	0.04	0.03	1	0.2768	0.3910	-0.4768	0.3168	35.187	-30.739	4.448
3	1	100	100	0.04	0.03	2	0.7266	0.7662	0.5266	0.7007	84.287	-68.004	16.284
3	1	100	100	0.04	0.03	2	0.3536	0.6382	0.0707	0.5282	63.816	-49.743	14.074
3	1	100	90	0.04	0.03	2	-	-	-	-	-	-	-
3	1	100	110	0.04	0.03	2	0.0190	0.4924	-0.3018	0.3814	44.320	-35.919	8.400

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3	1	100	110	0.04	0.03	2	0.6905	0.7551	0.4077	0.6582	83.058	-61.991	21.066
3	2	100	100	0.04	0.03	1	0.2500	0.5987	0.0500	0.5199	59.871	-50.457	9.413
3	2	100	80	0.04	0.03	1	0.8657	0.1933	-1.0657	0.1433	15.466	-13.904	1.562
3	2	100	120	0.04	0.03	1	1.1616	0.8773	0.9616	0.8319	105.276	-80.729	24.547

Regards,

John

To: "Badger, John" BadgerJ@zlic.com
 Cc: "Fox, Wanda" FoxW@zlic.com; "Buck, Bill" BuckB@zlic.com
 From: "Fish, Peter" FishP@zlic.com
 Subject: Fwd: Hedging and Option Data

Hi John,

Please respond to Hugh directly. I don't understand what exactly you are doing to hedge these fancy guarantees, so I better leave it to the expert to explain it to Hugh. He is also looking for some data on options – not sure why this would be of interest to him – but please get him what he wants. Let me know if there is something there that is too time-consuming to accommodate his request at this time.

Peter

To: "Fish, Peter" FishP@zlic.com
 Cc: "Fox, Wanda" FoxW@zlic.com; "Buck, Bill" BuckB@zlic.com
 From: "Dodo, Hugh" DodoH@zlic.com
 Subject: Hedging and Option Data

Peter,

It is great that you have brought in some derivatives expertise to Zoolander, I think that is a great step forward. I have been hearing a bit about the new hedging approach that we are now using on the old VA line, but none of the terms or descriptions sounded like anything I am quite used to, so I wonder if you could help me understand what Zoolander is currently doing to hedge our equity-linked exposures?

Another thing, which I think will also help my understanding, please get one of your staff to provide me with some sample options data - just a few representative terms using the same underlying assumptions as the pricing area.

Regards,

Hugh

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

From: "Wolfe, Danielle" WolfeD@zlic.com
To: "Fox, Wanda" FoxW@zlic.com
Sent: March 25, 2010 3:17PM
Subject: Re: Variable Annuity Writing Agent Survey – the new "VA Plus" line of business

Wanda,

Thanks for your note. I really thought our meeting yesterday was very productive.

To address the concern you raised regarding understanding contractholder behavior with regards to VA guarantees, we're going to make the survey of our VA writing agents an annual exercise. Specifically, we hope to determine the dynamic surrender behavior as a function of the In-The-Money (ITM), both for guaranteed living benefits and death benefits. In addition, we hope to get detailed benefit election information from this same survey.

I feel that we can get reliable information from our VA producers, because of their strong relationship with their clients, our contractholders. We hope that Actuarial staff can quantify both of these behaviors, and be able to use this information in your modeling function. Towards this end, I'm fairly confident that we can get the data in whatever format you need it. .

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

From: "Fox, Wanda" FoxW@zlic.com
To: "Wolfe, Danielle" WolfeD@zlic.com
Sent: March 25, 2010 7:26 AM
Subject: Re: Variable Annuity Writing Agent Survey – the new "VA Plus" line of business

Danielle,

I'm not sure if you grasped the importance of all the technical requirements that John Badger referenced during our meeting yesterday, but I thought I'd take the time here to break it down.

John needs us to measure and keep track of In-The-Money (ITM) every quarter. Of course, he'll also have available to him all the normal financial reporting measures, such as Account Value (AV), Cash Surrender Value (CSV), policy count, reserves, etc. I've also agreed to provide John CTE values for various levels of solvency capital accumulation. These values will come from our pricing models, which we will update with emerging experience of policyholder behavior. John plans to hedge our risk exposure on an ad hoc basis, when he deems our risk exposure has gotten too large. I understand that John is going to make this assessment using the ITM and CTE measures. He believes by using such a flexible hedging system, that he can keep hedging costs down.

Our long term goals are to hedge based on the liability portfolio characteristics, such as delta, gamma, vega, rho, both with and without specifically hedging the assets, however, we are still working on a plan as to how we can start measuring these factors. Actually managing against them will come after that.

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

From: "Wolfe, Danielle" WolfeD@zlic.com
To: "Fox, Wanda" FoxW@zlic.com
Sent: March 23, 2010 4:58 PM
Subject: Re: Variable Annuity Writing Agent Survey – the new "VA Plus" line of business

Wanda,

Thanks for your input, here is some additional info for you before our meeting tomorrow.

A quick note on the guarantees. It might help you to know that we are targeting these features to provide benefits which are reflective of historical index returns. They are NOT intended to provide the policyholder with amounts in excess of average historical market performance but rather will only be in the money if the market fails to perform according to historical averages. This might make you more comfortable with the ALM risk for these features as there should not be substantial benefits paid unless the markets underperform. This should also get you comfortable with avoiding any onerous ALM testing or requirements.

Also, we have decided on the GMDB and the GMIB for the VA Plus line. We will use margin offset fees to charge for the benefits. For the GMDB we were divided over whether to use a voluntary reset or premium accumulation for the guarantee. We compromised by using the larger of a voluntary annual reset of the fund level at the anniversary date and option (c): a return, upon death, of cumulative premium accumulated at 5% per annum. We didn't see any harm in being generous since this benefit pays out only if they die and only if the market performs below historical average—we think that is a rare combination. For the GMIB we can use the same 5% accumulation of premium assumption to buy annuity payments at our current purchase price assumptions. This allows us to easily tell the customer what their guaranteed monthly benefit will be. Since these benefits don't put us at much risk, I hope it won't take you very long to price for these.

Finally, regarding the introduction of new mutual funds, there's some risk if we introduce all these funds at the same time. First off, there's the administrative challenge of adding funds to our systems from three different fund families. Then, there's the marketing challenge of not overwhelming our producers with dozens of new choices. Plus there needs to be marketer education on the unique risks and opportunities of these much riskier funds. Finally, there is also the concern that we will not be able to negotiate consistent revenue sharing arrangements across all three of these fund families. If we don't do that, Zoolander would not be indifferent to policyholder investment choices. For these and other reasons, we've decided to proceed cautiously and introduce one fund family at a time, and to make each family's funds available over a period of time. I feel that this strategic choice allows us to minimize problems emanating from the aforementioned challenges.

Danielle

From: "Fox, Wanda" FoxW@zlic.com
To: "Wolfe, Danielle" WolfeD@zlic.com
Sent: March 23., 2010 9:15 AM
Subject: Re: Variable Annuity Writing Agent Survey – the new "VA Plus" line of business

Hi Danielle,

I know we are meeting to discuss this tomorrow so I wanted to share some preliminary thoughts with you before then. We are nowhere near having a comprehensive assessment of the costs and risks associated with these features. Having said that, here are my initial thoughts and questions to consider at our meeting:

- We may need to restrict our fund offerings where these investment guarantees are present, especially if we want to make all the new funds available, many of which are volatile. Alternatively, we would need to limit the guarantees to only that portion of the policyholder funds which have been invested in approved funds. Here is a listing of the most popular fund offerings associated with our existing VA contracts.

Available Funds For Zoolander VA Products

Fund Name	Average Return (μ)	Volatility (σ)	Annual Mgmt. Fee (m)
ZooBalanced	7.2%	20%	3.00%
ZooEquity500	8.4%	25%	1.25%
ZooFixedIncome	5.9%	10%	2.00%

- Although we would all agree that accounts with greater volatility likely have a greater chance for guarantee payouts, we do not yet have that relationship quantified. Similarly, although there seems to be some correlation between In-The-Money (ITM) and lapse rates for our current GMDB product, we are not sure how much stronger that relationship will be for guaranteed living benefits.
- GMAB, GMIB and GMMB would be new features at Zoolander. We'll need to invest some time to build the necessary knowledge base to fully understand these features. In particular, we have not typically subjected our VA line to asset/liability testing. I believe that we will need to do so for the VA Plus products. My initial thoughts would be to use an actuarial approach to fund the liability associated with the proposed features using high quality fixed income assets and setting a funding level at CTE 95% or so of the expected liability.
- We could take a multi-faceted approach to managing the ALM risk rather than think of ALM as simply an investment strategy approach. I can walk you through some ideas during our meeting.
- Obviously we will need to charge for these benefits somehow. What option do you think is most palatable for our client base, premium based charges or margin offset fees? We should reconsider the level of our surrender charges with the likely outcome, the need to increase surrender charges dramatically. This is all related to the issue of policyholder behavior which I will need help with as well.
- What were your thoughts regarding the voluntary reset? Was this going to be available every year? Every 3 years? Every 5 years?
- I have invited John Badger to our meeting. We will need his involvement to understand our ability to hedge the risks associated the VA Plus features. I have also invited Gaston Deer. He used to work with the reinsurance markets at a prior employer and may have ideas on whether reinsurance could help with some of these risks.
- With regards to the GMDB, the guaranteed benefit level doesn't really matter provided the client is willing to pay for the benefit they select. This feature is probably the easiest to develop quickly.

Wanda
X-345

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

From: "Wolfe, Danielle" WolfeD@zlic.com
To: "Fox, Wanda" FoxW@zlic.com
Sent: March 18, 2010 4:34 PM
Subject: Variable Annuity Writing Agent Survey – the new "VA Plus" line of business

Wanda,

I wanted to follow up with you on the conversation we had last week regarding the Variable Annuity writing agent survey. As you recall, we undertook an initiative which involved soliciting feedback from our top VA writers to understand how to better position our products in this market and improve our profitability in this line of business. While we received a lot of feedback, there seemed to be two prevailing themes for the improvement of the existing product, which the producers hope can be implemented in the new VA Plus product.

One of these requested features is to make available more separate account funds for the policyholder. They suggest making available funds from three different large mutual fund companies, including some fairly volatile sector-specific funds. These funds include those invested in minerals, energy and emerging markets, among others. Ironically, the mutual fund companies most often mentioned are those we've traditionally competed against for investor funds.

The other major request is to make available a variety of guarantees. As you know, the old product only included Guaranteed Minimum Death Benefits (GMDB). To this end, we compiled a list of potential features or benefits which might address the concerns raised by our VA producers. At this point, I would like some initial input from your team on which of these features might be easiest to implement quickly.

1. 10 Year GMAB: A GMAB which guarantees that the policy value will be the greater of the actual accumulated value or the initial premium accumulated at 2% per annum at any of the option rollover dates. The option rollover dates occur every tenth policy anniversary.
2. GMDB: There was a lot of interest in a GMDB with a wide range of opinions regarding what the benefit level should be. Suggestions included (a) a return, upon death, of cumulative premium paid (b) a return, upon death, of 90% of cumulative premium accumulated at 2% per annum and (c) a return, upon death, of cumulative premium accumulated at 5% per annum.
3. GMMB: A guarantee that offers a minimum return on premium at the time of contract maturity. The minimum return would vary based on the issue age of the annuitant with a higher rate being offered for the youngest issue ages. The intent would be to provide a guarantee to the policyholder that they would realize some historical average market return by maturity.
4. GMIB: This option was considered as an alternative to the GMMB. There was some preference to offer a benefit which was easier to communicate to potential clients and which allowed us to specify at policy issue what the monthly annuity benefit would be.

Obviously I don't expect a full pricing analysis for all of these features at this time however, if you let me know which of these are easily introduced and which might be more difficult, I can devise a plan to hopefully target some of the concerns raised by our VA producers in a timely fashion.

Danielle

From: "Wolfe, Danielle" WolfeD@zlic.com
To: "Seal, Frances" SealF@zlic.com
CC: "Bird, Odette" BirdO@zlic.com, "Fox, Wanda" FoxW@zlic.com
Sent: March 26, 2010 7:26 AM
Subject: Re: New Funds for VA Plus

Frances,

We do plan to offer new funds with the VA Plus product. I agree that we need to plan ahead so that we can avoid administrative problems and to make sure everyone stays focused on making the VA Plus product a success.

In addition to the concerns you have raised, I am also trying to address some concerns that Wanda Fox brought to my attention. She is worried that we will not have enough computing power to implement new techniques necessary to price and model the VA Plus product we want to launch. See the email below for some detail on this.

I'll setup a meeting with Odette, Wanda, and yourself to discuss administrative issues.

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

From: "Fox, Wanda" FoxW@zlic.com
To: "Wolfe, Danielle" WolfeD@zlic.com
Sent: March 12, 2010 2:14 PM
Subject: Computing Power

Just to follow-up on my comments at the Product Committee meeting, I have real concerns regarding our computing power to model the new product features for VA Plus, particularly in support of the dynamic hedging program.

I do have some ideas to reduce runtime requirements (e.g. grouping of policies with similar characteristics, randomly varying scenarios by policy to ensure faster convergence of Monte Carlo simulations, using static policyholder behavior assumptions to increase accuracy and speed, etc.) but each of these has its own limitations. Some options may have impacts on product design or features.

How do we best address these issues?

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

From: "Seal, Frances" SealF@zlic.com
To: "Wolfe, Danielle" WolfeD@zlic.com
CC: "Bird, Odette" BirdO@zlic.com
Sent: March 25, 2010 3:26 PM
Subject: New Funds for VA Plus

Danielle,

I saw in the monthly reports that we are moving forward with new funds for the VA Plus product. I think we should probably meet about this in the near future; I have some real concerns about the limitations of our VA administration system. I would also suggest including Odette Bird to get her perspective from the administration side.

Depending upon the number and types of new offerings, we may need to modify our systems or even upgrade them, neither of which are cheap options. In fact, the upgrade option would likely require bringing in consultants. For any system upgrade, our IT maintenance folks, as well as Odette's admin group, will probably have to be trained in using the changed system. Odette's personnel will also need to become familiar with the new funds' details. We would also need to update our Sarbanes-Oxley testing procedures and documentation. Lots to do!

As you can imagine, the severity of failing to deliver the system capabilities would be very high. We'd not only be dealing with irate contract holders and producers, but also with financial, regulatory and tax reporting authorities. However, I feel that we can maximize the probability of a successful implementation with proper planning and enough lead time.

Quarterly Product Report Zoolander Product Committee

Term Insurance

Product Description – traditional level term products and an annually renewable term (ART) plan, which features a level death benefit paid for by annually increasing premiums. The level term plans provide a level death benefit for a guaranteed level premium period of 10, 15, 20 or 30 years followed by an ART premium scale. Substandard policies and those that exceed retention limits are currently reinsured on a facultative YRT basis.

Market Position – very competitive. Sales continue to be very strong, in part due to our competitive 100% first year commission. Also, strong underwriting performance allows us to price our products very competitively in the better rate classes.

Value Proposition – low price due to our extraordinary underwriting department and facultative reinsurance process, which has yielded actual experience mortality to be in line with pricing mortality rates. The underwriters each have many years of experience. They have clearly defined processes and are adequately staffed to meet the number of underwriting requests given them. This has led to low volatility of claims.

Other Concerns – reinsurer (Rose Re) was recently downgraded. We may need to look for a new reinsurer if Rose Re continues to struggle. Some concern that Zoolander will not be able to reinsure at the current retention level and/or for the same price.

Experience – expenses for this block continue to run at the levels expected in pricing. Lapse and mortality stress tests are performed annually on the block. Only constraint on new business is capital support.

Recent Committee Decisions – product performing well; move repricing effort back to mid next year.

Guaranteed Investment Contracts (GIC)

Product Description – one- to five-year fixed-return contracts issued primarily to mutual funds and pension funds (institutional clients). Some of these contracts have surrender protection. There are covenants in most of our GICs that do not allow early surrender except in the event of a ratings downgrade of Zoolander.

Market Position – becoming very competitive. At the recommendation of the investment department, we have substantially increased our holdings in higher-yielding bonds and added private placement bonds to the portfolio backing these liabilities. In this environment the asset strategy has improved investment returns and permitted higher guarantees. Those impressive returns have allowed us to aggressively compete in this market while still maintaining good spreads.

Value Proposition – currently it is outstanding investment returns and higher guarantees. Private placement bonds are working out well. It is a win-win for both parties since a direct relationship between borrower and lender allows the borrower to save on underwriting and issuance costs and share the savings with Zoolander (as the lender). In addition, we get a yield that is somewhat higher than comparably rated public bonds.

Other Concerns – Surrender protection greatly mitigates liquidity and disintermediation risks. We have been able to pick up even more investment income by lengthening the term of our assets dramatically.

Experience – recently GICs have become more profitable may help carry the company in the future.

Recent Committee Decisions – work with distribution to see how we can expand the GIC line.

Variable Annuity

Product Description – standard individual variable annuity offering a collection of eight proprietary Zoolander mutual fund choices and a guarantee option through Zoolander’s general account.

Market Position – waning. Sales are way down. With the market declines, really need to add more investment options with better performance records to get customers to return to the product. Distribution is clamoring for living benefit riders.

Value Proposition – no real differentiation with the current product. New fund families will be available starting in 4Q. The enhanced product, VA Plus+, will add both a Guaranteed Minimum Death Benefit (GMDB) option and a Guaranteed Minimum Income Benefit (GMIB) option.

Other Concerns – probably need to do some advanced modeling with the new GMDB & GMIB options but we have plenty of time for that. Administrative systems need additional programming to handle an increased slate of fund offerings and that project is on schedule to be completed by the end of 3Q.

Experience – marginally successful on profitability but very disappointing sales. Senior management really wants this product line to do much better from both a growth and profitability perspective.

Recent Committee Decisions - for the GMDB we were divided over whether to use a voluntary reset or premium accumulation for the guarantee. We compromised by using the larger of a voluntary annual reset of the fund level at the anniversary date and a return of cumulative premium accumulated at 5% per annum upon death. We didn’t see any harm in being generous since this benefit only pays out if the insured dies and the market performs below historical average—a rare combo, we think. For the GMIB we can use the same 5% accumulation of premium assumption to buy annuity payments at our current purchase price assumptions. This technique allows us to easily tell the customer what their guaranteed monthly benefit will be.

Disability

Product Description – standard individual disability insurance policy. Guaranteed renewable to age 65. Optional return of premium rider which returns 70% of all premiums paid less claims paid at the end of every ten years.

Market Position – base product has poor sales but when paired with the optional return of premium rider, sales are generally meeting expectations.

Value Proposition – return of premium rider is very popular among our agents. Have several distributors who annually get over 90% of their commissions from selling the DI product (with the rider).

Other Concerns – base policy is reinsured but the return of premium rider is not. At the end of ten years, we have to return the premiums but the reinsurer doesn’t return its premiums to us. Rider assumes asset returns of 10% which are currently unobtainable. Pricing also assumes an industry standard morbidity rate so we monitor that.

Experience - problematic line of business for us. The base policies are profitable due to our excellent claims experience—far below industry average. Also, the persistency rate is very high, especially in the last half of the ten year period. However, this has led to losses on the return of premium rider because more premiums are being returned than was originally anticipated in pricing.

Recent Committee Decisions – revisit return of premium rider pricing 4Q this year.

March 19, 2010

Wanda Fox, Chair Product Committee

Blue Sky Reinsurance Intermediaries

500 Wilderness Lane, Out There 00000

December 21, 2009

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

Dear Mr. Lyon:

It was good talking with you yesterday. These are indeed interesting times. Everyone is looking for more capital and the market is moving quickly. Let me assure you that Blue Sky Intermediaries has the breadth and depth of experience to help your company. Our client list includes 17 of the top 20 direct writers but we also provide outstanding service to many smaller clients too. We have over a decade of expertise in designing reinsurance programs and we have extensive contacts with reinsurers both large and small.

Enclosed are the reinsurance proposals that you requested. I think you will find them self-explanatory, but I will call you in a few days to discuss them with you and anyone else on your staff that you wish to include in your decision-making.

In our attempt to place each quote on as level a playing field as possible, we have squeezed everyone's proposal into our one-size-fits-all template. As a result, there may be some details that the reinsurers provided but which are omitted in this presentation. In addition, Blue Sky can use our personal relationships with the reinsurers to get more information, if needed. So, feel free to ask any questions that you have which will help with your reinsurance evaluation.

After our discussion, I did visit informally with a handful of other account managers here at Blue Sky and I can confirm (without naming specific clients) that other companies have had similar discussions with Kelly Ratings on capital coverage ratios. It appears that on the capital side, Kelly is looking for liquid assets equal to at least 6% of statutory reserves for their A+ rated companies. The corresponding numbers are 5% for A ratings, 4% for A- ratings and 3% for B+ rated companies.

Thank you for letting Blue Sky partner with Zoolander in this research.

Sincerely,

Fuchsia Farina
Vice President
Ph (501) 555-0000

Blue Sky Reinsurance Intermediaries

Proposal for cedent

Zolander Life Insurance Company

Reinsurer	Amber Re	Amethyst Re	Aquamarine Re	Emerald Re	Garnet Re	Turquoise Re
Reinsurer's Kelly Rating	A- (3rd highest of 5)	A (2nd highest of 5)	A+ (highest rating available)	B+ (4th highest of 5)	A- (3rd highest of 5)	A (2nd highest of 5)
Reinsurer's Domicile	Bermuda	Bermuda	Bermuda	Bermuda	Connecticut	New York
Reinsurer Authorized in Cedent's Domicile?	No	No	No	No	Yes	Yes
Proposed Effective Date	12/31/2009	12/31/2009	12/31/2009	12/31/2009	12/31/2009	12/31/2009
Block of Business	Term Life	Term Life	Term Life Retention (after existing Rose Re amounts)	Term Life	Disability Insurance	Term Life
New Business/Inforce	existing block as of 12/31/2009, no new business	existing block as of 12/31/2009, no new business	existing block as of 12/31/2009, no new business	existing block as of 12/31/2009, no new business	New business sold beginning 1/1/2010	existing block as of 12/31/2009, no new business
Type of Reinsurance	Funds Withheld Coinsurance	Yearly Renewal Term	Coinsurance 100%	Modified Coinsurance	Funds Withheld Coinsurance 50%	Funds Withheld Coinsurance
Ceding Allowance	n/a	n/a	n/a	n/a	n/a	n/a
Renewal Year Expense Allowance	n/a	n/a	n/a	n/a	25% of ceded premium	n/a
Annual Risk Charges	n/a	n/a	n/a	n/a	5% of ceded reserves at beginning of year plus 5% of ceded premium	n/a
Other	Amber Re has extensive Term Life reinsurance capabilities. They have deals in place with dozens of other direct writers. Blue Sky has worked with them in more than 10 prior transactions.	Amethyst Re is new to the Term Life reinsurance market but they have a long history as a direct writer. Blue Sky has two other clients with Amethyst Re deals.	Blue Sky has not worked with Aquamarine before but they come highly recommended and have a great reputation within the industry. Blue Sky has found Aquamarine's pricing to be more competitive on new business than on inforce blocks.	Emerald Re is new to this market but the three main principals came over from Rose Re. They have very competitive pricing and a willingness to be flexible in contract terms & conditions. No current Blue Sky clients have consummated a deal with Emerald Re.	Garnet Re is a sub of the large disability writer Garnet Financial. Looking for additional disability exposure and have been fairly active in the market for the past 18 months. Blue Sky has no competed transactions with Garnet Re but has a half dozen deals with the parent company, Garnet Financial.	Turquoise Re is an old line reinsurer very familiar to everyone in this market. Approximately 20% of Blue Sky's Life Insurance clients use Turquoise Re with the transaction count above five dozen. Clients receive access to extensive mortality database information and invited to participate in Turquoise Re's Industry Mortality Conference annually.

March 10, 2010

R. Tomas Lyon IV
Chairman, President, CEO and COO
Zoolander Life Insurance Co
411 Main Street
Zoo Falls 54321

Dear Mr. Lyon,

I am pleased to inform you that Cobalt Management Consultants are on target to complete the analysis of Zoolander's Strategic Risk profile in advance of month end. We are in the final stages of publishing the complete report and producing the corresponding slide deck that we will present to your senior management team at your 2010 Strategy Review off-site meeting in Palm Beach on March 29th.

In the meantime, I am pleased to share a high-level qualitative mapping of Zoolander's Strategic Risk, reflecting our assessment of the life insurance industry and Zoolander's relative position within it. The quantitative details and rationale behind the Risk Map will be provided in the final report. This may assist you in structuring and focusing the remaining time of your off-site to jump-start action plans for the most significant strategic risks.

Best Regards,

Hans Blau
Partner
Cobalt Management Consulting, Inc.
Ph 987/555-1234

Attachment

Type of Risk	Probability	Expected timing in years					Changing probability over time	Summary
		1	2	3	4	5		
Industry								
Margin Squeeze	40%						Increasing	Cobalt predicts heightened competitive pressure in the Term market, due to a recent shift in policyholder wealth.
Commoditization	50%						Increasing	Cobalt predicts the lack of distinctive features in the Zoolander Term product will lead to commoditization of that product line.
Rising R&D/ capital expenditure costs	20%						Increasing	Cobalt predicts a small probability of a large downgrade in Zoolander's rating over the next 3 years could lead to higher capital costs and loss of strategic flexibility.
New Regulations	30%						Constant	Cobalt predicts that proposed new regulations negatively impacting Zoolander's VA products will pass in the next 1 or 2 years.
Technology								
n/a								
Brand								
Erosion	20%						Increasing	Cobalt predicts that the recent demutualization and resulting shift of priorities may harm Zoolander's image by current policyholders.
Competitor								
Emerging global rivals	20%						Increasing	Cobalt predicts the increasing likelihood of the emergence of global financial conglomerates within a few years that would threaten the existence of Zoolander.
Gradual market-share gainer	30%						Constant	Cobalt predicts that without the successful launch of guaranteed benefits in the VA line, other companies with such guarantees will gain market share on Zoolander.
Customer								
Customer priority shift	60%						Increasing	Cobalt predicts that Zoolander's LTD customer base will totally shift away in the near future from the standalone LTD product towards LTD riders attached to UL products.
Increasing customer power	60%						Increasing	Cobalt predicts that institutional investors in GIC products may, after a downgrade at Zoolander, use their considerable leverage from the surrender clause to extract better benefits.
Overreliance on a few customers	40%						Constant	Cobalt predicts that the income from the GIC line of business could dwindle quickly if relatively few contract holders renew elsewhere.
Project								
New Product Development							Constant	Cobalt predicts a high probability that the new VA Plus will not be launched successfully on time.
Failure	70%						Constant	Cobalt predicts that new VA features may not meet market expectations once the products are launched.
Business-development failure	40%						Constant	Cobalt predicts that the sizable surplus currently held, making acquisition activity possible, may be squandered if capital is not managed appropriately.
Merger or acquisition failure	30%						Constant	
Stagnation								
Flat or declining volume	70%						Increasing	In about two years, Cobalt predicts a high probability of declining volume of Zoolander's GIC product line due to lack of product innovation.
Volume up, margin down	65%						Increasing	Cobalt predicts a strong market increase in Term products, leading to decreased margins from new entrants to the market.
Weak pipeline	55%						Constant	Cobalt predicts that losing the facultative underwriting provided by Rose Re could lead to poor placement of large Term cases.

From the desk of
R. Tomas Lyon, IV

April 6, 2010

To Wanda Fox

Re Economic Capital

Please put together a memo that outlines what is involved in getting us from where we are today to where we need to be in order to implement Economic Capital (EC) at Zoolander.

I am becoming a believer in the EC framework you have been recommending. After listening to the rating agency speakers (including Otto Gold from Kelly Ratings & Analysis) at the industry conference earlier this week, I am convinced that EC has moved from just an expensive "nice to have," best practice item to almost a minimum standard of competence. We need to meet that challenge quickly.

Considering your prior updates on EC and based on some discussions with Kelly, articles I have read and conversations I have had with heads of other insurance companies. I think I have a pretty good handle on what needs to be done. Without a new CFO in place, I will be personally involved in this effort. Below are elements that I believe should be considered in our EC plan.

1. Cost. Please be sure to keep costs as low as possible.
2. IT. Please use existing systems and hardware as much as possible.
3. Definition of EC. It seems to me that there is a lot of confusing terminology out there. Please be specific about what definition Zoolander should use and what it means, exactly. Keep in mind all interested parties, and how to minimize the number questions they will be likely ask. While you're at it, it might also be good to jot down some reasons we can give different audiences for why we are doing this and what goals we hope to accomplish.
4. Frequency of calculation. I don't want to give this thing a life of its own. Please see if we can piggy-back our calculations from our routine semi-annual cash flow testing.
5. Borrow where possible. I also don't want to reinvent the wheel. Similar to the calculation frequency, see if you can use our conservative cash flow testing models. For risks not explicitly modeled, like operational risk, let's try to use some kind of factor model with relevant exposures. We can start by borrowing Kelly's factors for these risks, and as we gain experience we can substitute our own measures and methodologies.
6. Methodology. I want to make sure we use the one-year mark-to-market approach (I think that's what it's called) because Jack Benson over at Hearth and Home told me that he knew of a company that used the other method and ended up

Zoolander Life.....It's your life™

- spending way too much time. Please limit as much as possible the number of times this thing has to be rerun for different scenarios.
7. Type of information needed. To the extent possible please figure out what inputs and outputs could be piggybacked with other systems or reports that are currently in use. Also, if there is any kind of related need that you foresee in the near future, please incorporate that as much as possible in planning this EC effort so that we use our resources efficiently.
 8. Resources needed. Please make sure we can do this with the people we have. It's OK to outsource some of it for peak times while it is in development, if it does not cost too much. If there are any decisions like this to be made, be sure to show me the differences not only in cost but also how much time would be saved.
 9. Threats and Opportunities. As long as you are going through this thought process, it would be great if you could put together a list of problems we might run into and decision points that are likely to come up along the way. Also, anything you can give me that would help to tell the story to Kelly and the shareholders about why the way we are going about it is the best way would be helpful. And, it would also be prudent if you could list any objections you think they might have about what we are doing or how we are doing it.

Given the strong interest by Kelly, it is very important that we make this a top priority and get started as soon as possible. We should keep the Kelly people informed of our progress along the way. Some day I hope to convince them that Kelly's target capital figures are too conservative and not a good measure for Zoolander. Through EC calculations will help with that argument.

While I realize there is a lot to do, this is very important for Zoolander. Can you have an initial draft to me in a week or so?

Thanks,
Tomas

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