

Life Insurers  
US and Canada  
Credit Analysis

**Pan-American Life Insurance  
Company**  
And Subsidiary

**Ratings**

Security Class	Rating
Insurer Financial Strength	A

**Outlook**

Stable

**Financial Data**

Pan-American Life Insurance Co. Pan-American Assurance Co.		
Financials	Date	\$ Mil.
Net Income	12/31/07	26
Total Adjusted Capital	12/31/07	336
Prism Score	12/31/06	AAA

**Analysts**

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**Related Research**

- [Review and Outlook 2007–2008: North American Life Insurance, Special Report, Dec. 3, 2007.](#)
- [Subprime Mortgage Exposure for US Life Insurers — Update and Outlook, Special Report, Feb. 21, 2008.](#)
- [US Life Insurers: Large Commercial Mortgage Exposure Under Control, Special Report, April 15, 2008.](#)

**Rating Rationale**

- The rating of Pan-American Life Insurance Company (PALIC) is supported by its balance sheet strength and its niche position in the Latin American and Hispanic markets. The rating of its wholly owned subsidiary, Pan-American Assurance Company (PAAC), is supported by an explicit guarantee from PALIC. The ratings also recognize the significant progress management has made in streamlining operations and in addressing legacy issues, which have caused considerable volatility in past results.
- Fitch views Pan-American's risk-based capitalization as very strong based on Prism, Fitch's capital model. Pan-American's year-end 2006 Prism score indicated that the company's available capital was 122% of required capital at the 'AAA' level, and Fitch anticipates that the score will remain in the 'AAA' range for 2007 and 2008. The company grew surplus by \$17 million in 2007 due primarily to improved statutory earnings. The company has no exposure to subprime mortgage-related securities, collateralized debt obligations (CDOs) or collateralized loan obligations (CLOs). Operating leverage is very low.
- Fitch believes that Pan-American's operating profitability continues to improve and become more stable as management focuses on streamlining operations and addressing legacy issues, which historically created volatility and unpredictability of results. Management is also improving transparency and expects to have audited GAAP statements by the end of 2008.
- Fitch's concerns include Pan-American's continued lack of scale and the company's ability to grow profitably in its target markets. The company's primary earnings driver currently is a closed block of US ordinary life business, which is not part of the target market going forward. Fitch also continues to focus on the prudent and effective deployment of capital as the company seeks to grow in its target markets.

**Key Rating Drivers**

- Fitch anticipates that Pan-American's balance sheet strength will continue to be the key driver of its Stable rating over the medium term. An unexpected significant decline in statutory surplus or the company's Prism score could put pressure on the rating. Stable earnings growth in the company's target markets over time could be a positive for the rating.
- Pan-American may enter into joint ventures or execute strategic acquisitions to expand distribution and grow in the Latin American and Caribbean markets. The company's risk-based capital (RBC) ratio is expected to remain above 400%, including growth and capital deployment. As part of its strategy to exit the real estate management business, Pan-American is expected to sell its interest in the hotel joint venture over the next few years.

## Key Rating Issues

**Balance sheet remains strong.** Fitch anticipates that Pan-American's Prism score will remain in the 'AAA' range for the full years of 2007 and 2008. The company's NAIC RBC ratio was 574% at year-end 2007, down slightly from 583% in 2006. Total adjusted capital (TAC) grew \$17 million due primarily to improved statutory operating earnings. The decline in RBC was driven by a higher growth rate of liabilities and a \$3 million dividend to the mutual holding company (MHC). Nevertheless, the company's operating leverage remains very low relative to peers.

**Relatively low exposure to credit risk in the investment portfolio.** Consolidated risky assets were 57% of TAC at year-end 2007 compared to a 72% average for the industry (estimate). Exposure to residential mortgage-backed securities (RMBS) is significant in relation to TAC, but the securities are all agency-backed paper. There is no subprime, CDO or CLO exposure. Total asset-backed securities (ABS other than RMBS) are \$9 million—\$3.4 million is in commercial mortgage-backed securities (CMBS.) All are rated 'AAA' or 'AA'. There were no impairments through year-end 2007. About 38% of below-investment-grade bonds are sovereign bonds of Latin American countries, which require investment in order to operate there.

**Improved operating profitability.** Management continued to reduce core operating expenses through 2007. Expense management and market discipline will be critical going forward as the company executes its growth plans. Expenses are expected to be slightly higher in 2008 due to new initiatives. Also pressuring earnings are more conservative underwriting and investment assumptions for 2008. Nevertheless, Fitch believes that the company is laying the groundwork for sustainable improvements going forward.

**Strategy still evolving.** Pan-American expanded its strategy in 2007 to include the US Hispanic low- to middle-income market through low-cost distribution channels. The company is developing partnerships with several Hispanic direct-marketing organizations. They are developing limited benefit products that will piggyback on transactions already carried out by direct-marketing organizations. The products will insure remittances and offer protection to Hispanics in the US and their families in Latin America. Management is also implementing initiatives to strengthen the company's other core segments—International Dollar and Latin American Markets.

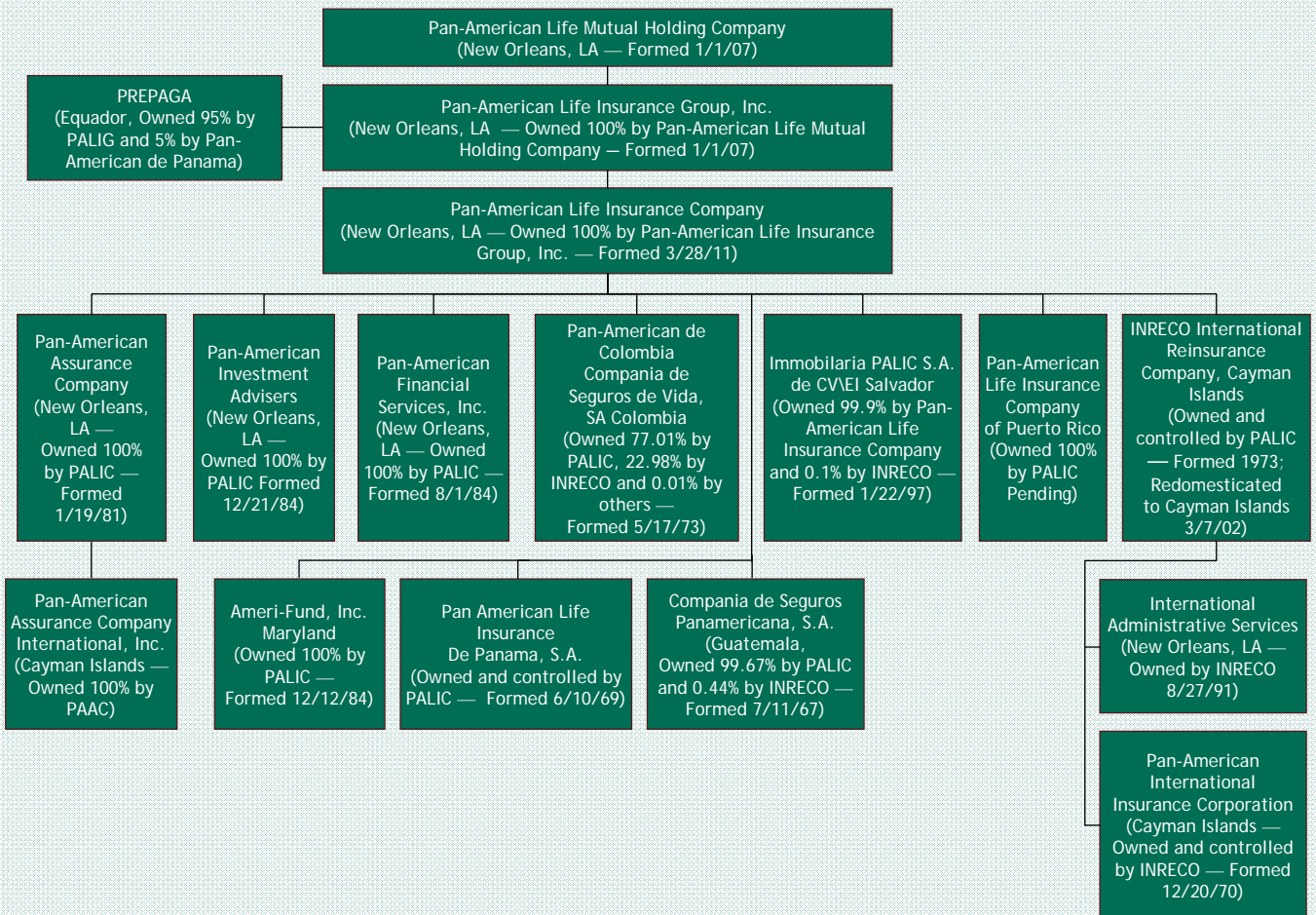
## Company Description

### Ownership Structure

PALIC is the primary operating subsidiary within the Pan-American Life Insurance Group (PALIG), a mutual holding company with consolidated assets of \$1.6 billion at year-end 2007. PALIC had \$1.6 billion in total admitted assets and \$334 million of total adjusted capital at year-end.

Pan-American, which was originally incorporated in 1911, converted to a MHC Jan. 1, 2007. The group, which has affiliates and branches in the US, Puerto Rico and other countries in Central and South America, initially conducted all of its business in Latin America, where it has a niche position. The company has been operating in Colombia, Guatemala, Panama, Ecuador, El Salvador, Honduras and Puerto Rico for several decades. In the US, Pan-American is currently licensed in 44 states and the District of Columbia.

**Pan-American Organizational Chart**

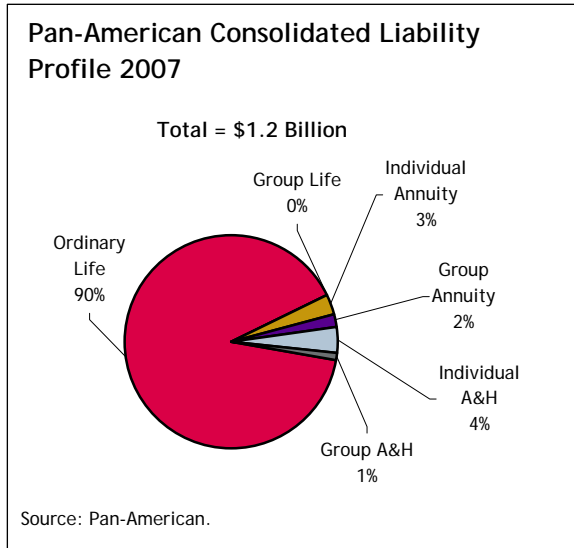


Source: Pan-American Life Insurance Company.

**Products, Target Markets and Distribution**

Pan-American operates through three core segments: the Latin American Markets segment, the International Dollar segment and targeted Domestic Markets. The Latin American Markets segment operates in Colombia, Guatemala, Panama, Ecuador, El Salvador, Puerto Rico and Honduras, where Pan-American has been for decades and enjoys solid market positions. The company sells ordinary and group products to individuals and businesses through seven branches and affiliates. Pan American’s long-term commitment to Latin America as well as its bilingual employees, brand recognition and its understanding of local markets and the Hispanic culture are key competitive advantages. The primary individual products are universal life and level-premium term offered in either US dollars or local currency. The group operations target financial institutions, multinational firms and small businesses seeking a variety of group life and health products that do not require customization. The products sold include major medical, disability, accidental death and dismemberment, dental, critical illness and other health products. The most significant product in this segment is major medical.

Pan-American’s International Dollar segment is geared primarily toward wealthy individuals and business owners in Latin America and the Caribbean who seek financial solutions in US dollars. This market is a significant niche for Pan-American. Individual



life is the only product sold in this market, with universal life (UL) accounting for the bulk of sales. Most of the premium in this segment is sold through brokers and written through Pan-American's Cayman subsidiary, Pan-American International Insurance Corp. (PAIIC). A new Cayman subsidiary is also being established with a branch in Florida to take advantage of a new Florida law allowing sales in the state.

In the domestic US market, Pan-American is focused on providing limited benefit worksite products, including employer paid and voluntary group life and medical plans to targeted markets. Pan-

American has overhauled its worksite strategy and established a new exclusive distribution relationship, which drove significant growth in 2007. The segment targets Hispanics living in the United States to leverage Pan-American's competitive advantage. The company also has a niche in the special markets segment, which provides stop-loss, accident, dental and disability products to the US employer market.

A new key target market is Hispanics in the US who send remittances to relatives in Central and South America. The company has developed protection products, such as accidental death, to insure the remittances. The sale can piggyback on transactions already taking place through direct marketers and other channels. This is expected to drive profitable growth and be a key area of focus for the company.

## Financial Analysis—Operating Company

### Profitability

Fitch believes that Pan-American's operating profitability continues to improve and become more stable as management focuses on streamlining operations and addressing legacy issues, which have historically created volatility and unpredictability. Management is also improving transparency and expects to have audited GAAP statements by the end of 2008.

Pan-American generated strong results in 2007 due in part to a 16% decline in general operating expenses. In terms of segments, the primary driver of the earnings growth is the company's closed block of US ordinary life business, which benefited from better-than-expected mortality and investment performance. The investment performance was driven to a large extent by private equity distributions, which are not expected to repeat in 2008. The closed block is expected to remain the primary driver of earnings over the near term.

The International Dollar segment, which is the second most important contributor to Pan-American's results, posted a GAAP loss in 2007 due to a deferred acquisition cost (DAC) write-off related to a legacy mispriced product and a realignment of distribution. Going forward, however, this segment is expected to be a strong contributor.

The Latin American Markets segment was not a significant contributor to 2007 results due to lower interest margins and deteriorating loss ratios in the group health line. The

## Operating Performance

(\$ Mil.)

	2007	2006	2005	2004	2003
Total Premium Income	165	156	142	207	207
Investment Income	91	89	88	96	104
Total Revenue	285	272	252	353	352
Gain Before Federal Income Tax and Dividend	39	14	1	26	16
Policyholder Dividend	5	5	7	6	5
Pretax Gain from Operations	34	9	(6)	20	11
Federal Income Tax	7	4	(2)	5	2
Net Operating Gain	27	5	(4)	15	9
Realized Capital Gains	2	(11)	(1)	(1)	1
Net Income	29	(6)	(5)	15	10
Total Net Admitted Assets	1,591	1,685	1,651	1,620	1,590
Operating Return on Total Adjusted Capital	8.33	1.54	(1.39)	6.49	7.83
Pretax Return on Total Assets Pre-Dividend	2.39	0.82	0.05	1.62	0.83
Pretax Return on Total Assets Post-Dividend	2.08	0.52	(0.37)	1.25	0.56
Pretax Operating Margin	11.91	3.22	(2.38)	5.71	3.09
Expense Ratio	5.96	6.45	6.43	7.45	6.23
Net Investment Yield	5.97	5.90	5.91	6.75	7.27
Mortality Ratio	42.61	42.82	40.53	47.35	45.88

Note: Statutory accounting principles.

Source: Highline Data.

deteriorating group loss ratios in Latin America are part of an industry trend, which Pan-American is aggressively addressing through product restructuring and repricing and expects improvement in 2008. The new US Hispanic initiative is not expected to break even for a couple of years.

### Asset Quality, Liquidity and Asset Liability Management

Pan-American is exposed to interest rate risk primarily through its universal life blocks of business, which comprise about 90% of in-force reserves when all affiliates are included. (Note: the tables in this report reflect the primary US entities but do not include all affiliates.) Fitch believes that the primary interest rate risk is spread compression due to the minimum guaranteed rates provided by these products. Pan-American's investment portfolio has generally performed well in support of the product line, providing above-average investment yields and relatively low risk. Cash flow-testing results show that this block in aggregate is adequately reserved in a variety of interest rate scenarios.

Pan-American began its planned exit from the real estate management business with the sale of its home-office building for \$54 million in 2006. Management also expects to sell its 66% interest in the Hotel Intercontinental over the next few years.

Pan-American's bond investments in real estate investment trusts, which have strong covenant protections, and its agency RMBS have also been significant contributors to the company's investment results. These assets comprise 6% and 19.6% of the investment portfolio, respectively. Pan-American owns no subprime or whole-loan mortgage securities. There were no other-than-temporary asset impairments through 2007, although some are expected in 2008.

Fitch views Pan-American's asset risk as moderate based on its risky-asset ratio, which measures below-investment-grade bonds, nonperforming real estate, unaffiliated common stock and Schedule BA or "other" assets as a percentage of TAC. While Pan-American's overall exposure to below-investment-grade bonds is low, Fitch notes that the company is required to purchase government bonds of Ecuador, Honduras, El Salvador and Panama in order to sell insurance in those countries. These securities are

### Investment Portfolio

(\$ Mil.)

	2007	2006	2005	2004	2003
Total Invested Assets	1,535	1,561	1,523	1,496	1,411
% Bonds	81.3	77.8	79.7	76.1	75.7
% Common and Preferred Stock	4.2	2.5	2.2	2.2	1.2
% Mortgage Loans	0.8	1.2	1.6	1.9	2.4
% Real Estate	0.8	0.8	2.8	2.9	3.1
% Policy Loans	6.1	6.1	6.4	6.7	7.1
% Cash and Equivalents	3.1	7.5	3.3	5.8	6.2
% Affiliated Investments	1.5	1.4	1.1	1.5	1.7
% Other Invested Assets	2.2	2.7	2.9	3.0	2.6
Below Investment Grade/Total Adjusted Capital (%)	32.4	29.6	33.3	40.7	49.4
Troubled Real Estate/Total Adjusted Capital (%)	0.0	0.0	0.1	0.1	0.1
Unaffiliated Common Stock/Total Adjusted Capital (%)	14.7	12.3	11.6	13.3	7.3
Schedule BA Other Invested Assets/TAC	9.9	13.3	15.2	18.1	15.5
Risky-Assets Ratio	57.0	55.2	60.3	72.1	72.4

Note: Statutory accounting principles.  
Source: Highline Data.

generally rated 'BB' or below and account for approximately 39% of the group's below-investment-grade bonds.

Fitch views Pan-American's liquidity risk as modest given its liability structure. The company's liquidity is considered strong based on Fitch's ratios of demand liabilities in relation to liquid assets. Liquidity is supported by publicly traded investment-grade bonds and cash of about \$1 billion at March 31, 2008.

### Statutory Capitalization

Fitch views Pan-American's risk-based capitalization as very strong based on Prism, Fitch's capital model. Pan-American's year-end 2006 Prism score indicated that the company's available capital was 122% of required capital at the 'AAA' level, and Fitch anticipates that the score will remain in the 'AAA' range for 2007 and 2008. The company grew surplus by \$17 million in 2007 due primarily to improved statutory earnings.

Pan-American's NAIC RBC ratio is very strong at 574% as of year-end 2007, and Fitch estimates it was roughly the same as of March 31, 2008. Pan-American's consolidated operating leverage—adjusted liabilities as a percentage of capital and surplus—has been consistently low relative to peers and the industry, indicating that the company should be able to grow without statutory strain. Fitch's primary concern is that management deploy capital in a prudent and disciplined way in support of the company's strategic direction. Fitch believes that the company is taking a cautious approach to potential acquisition targets.

### Liquidity

(\$ Mil.)

	2007	2006	2005	2004	2003
Public Bonds/Total Bonds (%)	86.3	81.8	79.1	77.4	76.5
Liquidity Ratio 1 (%)	101.3	101.6	87.6	83.6	79.5
Operating Cash Flow Coverage (x)	1.0	1.0	0.9	1.1	1.2
Adjusted Liabilities and Separate Accounts	1,257	1,369	1,364	1,375	1,357
% Life Reserves	77.7	72.2	73.0	74.6	75.0
% Accident and Health	7.4	5.9	5.9	4.6	4.8
% Annuities and Pension Deposits	7.5	8.6	9.0	9.0	12.2
% Other	7.4	7.7	7.1	6.9	3.2
% Separate Accounts	0.0	5.6	5.1	4.9	4.7

Note: Statutory accounting principles.  
Source: Highline Data.

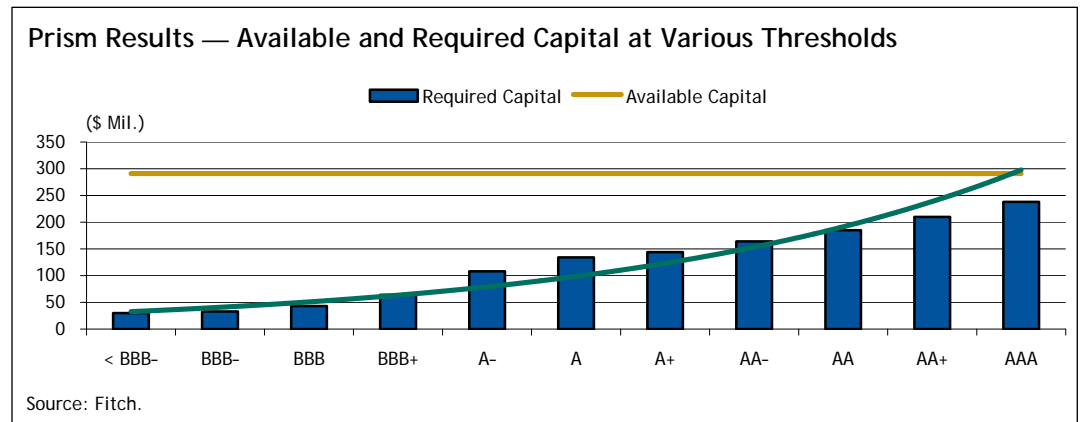
**Capitalization**

(\$ Mil.)

	2007	2006	2005	2004	2003
Beginning-of-Period Total Adjusted Capital	314.7	287.3	245.0	232.6	221.7
Net Operating Gain	27.0	4.6	(3.7)	15.5	9.1
Net Realized Gain/Loss	2.3	(10.8)	(1.4)	(0.9)	0.5
Change in Unrealized Gain/Loss	0.1	20.9	(6.0)	4.5	(6.3)
Change in Reserve Valuation	0.0	0.0	7.7	0.0	0.0
Paid-in Capital/Surplus	0.0	0.0	0.0	0.0	0.0
Dividends to Stockholders	(3.5)	0.0	0.0	0.0	0.0
Other Changes	(7.1)	12.7	45.6	(6.8)	7.5
Total Changes	18.8	27.4	42.3	12.4	10.9
End-of-Period Total Adjusted Capital	333.5	314.7	287.3	245.0	232.6
Statutory Surplus	306.5	289.0	269.9	222.9	211.1
Asset Valuation Reserve	24.7	23.8	14.6	19.5	19.0
1/2 Policyholders' Dividends	2.4	1.9	2.8	2.6	2.6
Regulatory Capital (Total Adjusted Capital)	333.5	314.7	287.3	245.0	232.6
Required Capital (Company Action Level)	58.1	54.0	53.4	56.8	56.5
Risk-Based Capital Ratio (%)	573.9	583.0	537.8	431.2	411.5
Assets/Statutory Surplus (x)	5.2	5.8	6.1	7.3	7.5
Adjusted Liabilities/Statutory Surplus (x)	4.1	4.5	4.8	5.9	6.1

Note: Statutory accounting principles.  
Source: Highline Data.

PALIC explicitly guarantees all the obligations of its affiliates, Pan-American Assurance Company and Pan-American International Insurance Company, as well as its branches outside the United States. They do not guarantee their affiliates in Panama, Colombia, Guatemala and Puerto Rico. These operations, however, are well capitalized in relation to the regulatory requirements in those countries.



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