M Benefit Solutions®
Bank Strategies
Total solutions for attracting, retaining, and rewarding top talent

ICBA Preferred SERVICE PROVIDER

Fourth Quarter 2009

THE BOTTOM LINE
EXECUTIVE AND DIRECTOR BENEFITS AND BOLI

Assessing the Impact of the Decline in the Commercial Real Estate Market on Life Insurers

*By: M Financial Group's Product Management Team**

Introduction

Concerns about the stability of life insurers and other financial service companies are growing as economists predict that the commercial real estate and mortgage market will be the next domino to fall in the current recession. Life insurers allocate approximately 15% of their assets to commercial mortgage-related investments. Real estate values have fallen dramatically over the past two years and in light of tighter credit markets, forecasters predict a dire scenario for commercial mortgages. Default levels on commercial mortgages have risen to their highest levels in more than 15 years and are expected to continue to rise through 2010.

Commercial Mortgage Outlook

Life insurers issue about 10% of the commercial mortgages in the U.S. In addition, they invest in commercial mortgage-backed securities (CMBS), which comprise between 25% and 35% of the market. The bulk of the remaining market, approximately 50%, is issued by banks. These assets—bank-issued commercial mortgages, CMBS, and life insurer-issued commercial mortgages—each have different characteristics; therefore default rates will vary for each group, according to financial analysts.

Life insurers tend to prefer to issue loans with terms of ten years or more, matching the long-term nature of their liabilities. These loans tend to generate predictable cash flows, are less likely to be in need of refinancing, and have moderate loan-to-value ratios. Most of the commercial loans held by insurance companies were issued prior to 2006 when underwriting standards were more stringent.

CMBS occupy a middle ground between bank-issued and life insurer-issued commercial mortgages. CMBS tend to be comprised of loans with terms of between five and ten years. The general consensus is that loans backing CMBS are somewhat less risky than those held by banks and somewhat more risky than those held by insurance companies. Recent delinquency rates support this perspective. As of the end of 2008, the delinquency rate was 5.36% for banks, 0.95% for CMBS, and 0.07% for insurance companies.

According to industry analysts, it is unlikely the stress from defaults and foreclosures on commercial mortgages will severely impair the financial strength of life insurers, despite projections that losses will accelerate through 2011, and possibly beyond. While the extent of the downturn in the commercial mortgage market is uncertain, Moody's uses a cumulative ten-year expected loss projection of between 3% and 4% for losses on CMBS, and between 7% and 9% in an adverse scenario, in rating CMBS. For commercial mortgages issued by life insurers, Moody's predicts that loss rates could triple from their historical rate of 0.8%.

(Continued on next page)

Fitch Ratings stated their opinion that although increased losses are expected on commercial real estate-related assets, the loss exposure for U.S. life insurers will be "mitigated relative to other market participants due to their investment in higher credit quality assets and relative conservative underwriting." Fitch's projection for potential losses for the industry under stress scenario testing ranged from 8% to 10% of industry capital.

According to Standard & Poor's, life insurers generally invest in the "most senior and highest quality" tranches of CMBS and 95% of the industry's holdings are rated A or better. In addition, S&P says stress testing of insurer portfolios indicates that foreclosures would have to exceed 5% before any impact on ratings is seen, although companies with higher allocations to commercial mortgages would be more vulnerable.

Conclusion

It is expected that delinquencies, foreclosures, and restructurings will rise in 2010 on commercial real-estate related assets. The impact on life insurers will be increased investment losses (realized and unrealized) on these assets. However, it is not expected that these losses will severely weaken the financial strength of U.S. life insurers or cause significant rating downgrades since current financial strength ratings already take these factors into account. Exceptions would be insurers with large exposures to CMBS issued between 2006 and 2008 or insurers with above average investments in direct commercial mortgages that have above average delinquency/foreclosure rates.

*Members of M Financial's Product Management Team include: Derrick Hanson, *Product Management Specialist;* Jennifer Martell, *Due Care and Competition Specialist;* Dennis McMahan, *Senior Product Analyst;* Wayne Tonning, *Director, Product Development;* Paul Yates, *Director, Product Development.*

2010 ICBA National Convention & Techworld

March 17—21, 2010

M Benefit Solutions - Bank Strategies is once again a proud sponsor and exhibitor at the upcoming 2010 ICBA National Convention & Techworld at the Gaylord Palms in Orlando, Florida.

ICBA Techworld - Empowering Banks on Main Street

Please visit us on **Main Street, Booth 415**, enter to ***win an Amazon Kindle*** and pick up your bank's customized ***BOLI Empowerment Page***. Join us on Wednesday, March 17, as we dish out ***free Haagen Daz ice cream!***

Workshop: "Thrive in Today's Economic Environment with Executive Compensation Plans and BOLI"*

Thursday, March 18; 7:30–8:30 AM
Room: Miami

M Benefit Solutions - Bank Strategies' Advisor, Tom Jordan, will explore how innovatively designed executive compensation plans, allied with the strategic use of bank owned life insurance, can help a community bank thrive in today's economic environment while laying a foundation for future prosperity. Come away with a better understanding of how to use a compensation strategy that will enhance productivity and improve profits by getting key people focused on key performance factors.

Attend and you may win an ***Odyssey White Ice Sabertooth Putter***!

*CPE Accredited

FASB Accounting Standards Codification™

On July 1, 2009, the Financial Accounting Standards Board (FASB) released the authoritative version of the *FASB Accounting Standards Codification™* as the single source of authoritative nongovernmental U.S. Generally Accepted Accounting Principles (GAAP). All existing accounting standard documents are superseded. As such, benefit accounting principles such as APB 12, FAS 106 and FAS 87 will now be referred to as ASC 715. And, FASB Technical Bulletin 85-04 related to accounting for purchases of life insurance will now be referred to as ASC 325.

The Codification does not change GAAP. Rather, it provides a new structure which reorganizes the thousands of U.S. GAAP pronouncements into approximately 90 accounting topics that are displayed in a consistent structure. In a separate section, the Codification also includes relevant Securities and Exchange Commission (SEC) guidance that follows the same topical structure. However, it does not contain the entire population of SEC rules, regulations, interpretive releases, and staff guidance.

Section 409A Document Compliance Program

It was reported in early November that the IRS has a limited document corrections program in the works under Section 409A. There was hope the program would be announced before the end of the year, but to date, there has been no announcement. We will send an email update on the corrections program whenever it is announced.

Advisor Firms

M Benefit Solutions - Bank Strategies

Michael Elliott
mike.elliott@mben.com

1125 NW Couch Street, Suite 900
Portland, OR 97209
Phone: 503.414.7622; Fax: 503.238.1815

Thomas J. Jordan
tjordan@ecicompanies.com

Austin, TX
Phone: 512.656.9950

Capital Strategies Group, Inc.

David F. Byers
dbyers@csginc.us

Wes Caudell
wcaudell@csginc.us

Richard Meadows
rmeadows@csginc.us

Two Metroplex Drive, Suite 111
Birmingham, AL 35209
Phone: 205.263.2400; Fax: 205.263.2300

Corrigan & Company

Michael E. Corrigan
mcorrigan@corrigan-co.com

322 N Nopal Street
Santa Barbara, CA 93103
Phone: 800.456.3377; Fax: 805.962.5053

Dan Wagner
dwagner@corrigan-co.com

Chesterfield, MO
Phone: 636.530.1635

ECI/Bank Benefits

Thomas V. Lynch
tlynch@ecicompanies.com

1650 West 82nd Street, Suite 850
Minneapolis, MN 55431
Phone: 952.885.2727; Fax: 952.885.0995

Evergreen Consulting, Inc.

James Cheney
jcheney@evergreenci.com

Robert Kozloski
rkozloski@evergreenci.com

1400 Williams Street
Chattanooga, TN 37408
Phone: 423.756.3828; Fax: 423.265.0735

Financial Designs Ltd.

Gerald Middel
jmiddel@fdltd.com

1775 Sherman Street, Suite 1800
Denver, CO 80203
Phone: 303.832.6100; Fax: 303.832.7100

GW Financial, LLC

John Gagnon
jgagnon@cfnii.com

2 Haven Street, Suite 301
Reading, MA 01867
Phone: 781.942.5700; Fax: 781.942.5710

John F. Saunders
Edgewater Advisors Ltd.
saunders@edgewateradvisorsltd.com

Pleasantville, NY
Phone: 914.747.0626

SilverStone Group

Thomas J. Von Riesen
tvonriesen@ssgi.com

11516 Miracle Hills Drive
Omaha, NE 68154
Phone: 800.288.5501; Fax: 402.963.4084

Jamie Corbin
jcorbin@ssgi.com

Des Moines, IA
Phone: 515.285.5882

About M Benefit Solutions - Bank Strategies

M Benefit Solutions - Bank Strategies, based in Portland, Oregon, is a division of M Benefit Solutions, a Subsidiary of M Financial Group. Please go to www.mfin.com/DisclosureStatement.htm for further details regarding this relationship. M Benefit Solutions is a recognized leader in the community bank executive and director benefits and BOLI marketplace. Through a network of firms located in key markets across the country, M Benefit Solutions - Bank Strategies helps banks attract, retain, and reward key executives and directors through the design, implementation, and administration of benefit programs that maximize the use of a bank's financial resources. M Benefit Solutions - Bank Strategies is the Independent Community Bankers of America's ("ICBA") Preferred Service Provider for executive and director benefits and BOLI. For more information, please visit www.mben.com/bank.

M Benefit Solutions®
Bank Strategies

An M Financial Group Company

ICBA
Preferred
SERVICE PROVIDER

M Benefit Solutions - Bank Strategies
M Financial Plaza
1125 NW Couch Street, Suite 900
Portland, OR 97209
503.238.1813
fax: 503.238.1815
www.mben.com/bank