BOLI-Related Earnings Announcements 2008-Q1

Wachovia's recent announcement of major losses associated with their BOLI stable value policies prompted numerous client inquiries. According to their 8-K filing, Wachovia posted a loss of $315 million on these policies for the period ending March 31, 2008. A subsequent filing of the bank's 10-Q disclosed very little in the way of additional detail regarding the specific nature or cause of these losses. Through our own research and industry sources, we can offer some additional commentary on this development; though we caveat this by saying these comments should not be considered official or necessarily definitive. While we consider these resources to be reliable and well-informed, we nevertheless must caution our readers about relying on this information as being publicly documented or official.

Wachovia

Wachovia's recent 10-Q filing references three BOLI plans associated with the reported losses out of an overall BOLI portfolio of approximately $15 billion, three-quarters of which was held in separate accounts, where as the remaining 25% are in general accounts. Stable value wrap protection was applicable to approximately 95% of the separate account assets.

According to our information, Wachovia's latest BOLI acquisitions were divided between two carriers, Aegon and Nationwide. The Aegon purchase, approximately $400 million, was invested primarily in a fixed income hedge fund of funds named Falcon. This fund's characteristics include 4-7 times gross leverage and an overall credit quality target of AA-. (It is also the same fund that was purchased by Fifth Third.) We have heard that this policy was stable value wrapped by BofA or an Aegon affiliate.

The other two policies were purchased from Nationwide. They were more than $1 billion in total and stable value wrapped by Royal Bank of Canada (RBC). The Nationwide policy assets were invested predominantly in an alternative MBS investment called FIDAC with an 8x gross leverage. We cannot be certain whether the Wachovia losses are tied exclusively to Falcon and/or FIDAC, or possibly to other risky investments. If, however, the reported losses stemmed from a book value (BV) to market value (MV) cap requiring a write-down in BV, the market losses must have been extraordinary to breach the standard 115% BV/MV stable value threshold by a margin of $315 million)! We have also been told that Falcon and FIDAC have each experienced cumulative losses exceeding 40% since last July.

While it is true that Wachovia's valuation losses are substantial, they represent less than 3% of their total stable value BOLI holdings and appear to be attributable primarily to two aggressive, highly leveraged investment portfolios. It has been said that both Falcon and FIDAC imposed liquidity restrictions that prevented Wachovia (and previously Fifth Third) from reallocating to other stable value investment divisions in time to avoid major market value reductions. In discussions with leading SVP providers, it is our understanding that traditional bank eligible portfolios (e.g., benchmarked to Lehman MBS and/or Lehman Aggregate Indices – i.e., non-leveraged) have never breached stable value thresholds requiring either an adjustment in BV or repositioning to money market. We remind you that most mature SVPs had no such cap feature at all. We note that while it is likely that Wachovia's valuation loss resulted, at least to some extent, from breaching stable value thresholds, other explanations (for instance, Wachovia and/or its auditors concluding that

In discussions with leading SVP providers, it is our understanding that traditional bank eligible portfolios (e.g., benchmarked to Lehman MBS and/or Lehman Aggregate Indices – i.e., non-leveraged) have never breached stable value thresholds requiring either an adjustment in BV or repositioning to money market.

certain investment losses will never be recovered) cannot be dismissed.

BB&T

In another BOLI earnings development, BB&T recently disclosed a loss with respect to its BOLI holdings. According to BB&T's quarterly call report, as of 12/31/2008, the BOLI portfolio was approximately $2.65B (or 28.36% of capital). The following statement was provided in their most recent 10-Q filing: "Other income, including income from bank-owned life insurance, totaled $49 million for the first quarter of 2008, a decrease of $13 million, or 21.0%, compared to the first quarter of 2007. The decrease in 2008 primarily resulted from a decline of $15 million in bank-owned life insurance primarily resulting from a valuation adjustment that resulted from a decline in the underlying assets of certain bank-owned life insurance policies."

While market knowledge of the BB&T development seems to be quite limited, we would observe that, unlike the Fifth Third and Wachovia disclosures, BB&T makes no specific mention of stable value. Thus, it is quite possible that their loss could have resulted from other causes (for example a change in the value of unwrapped assets, or an adjustment due to securities defaults, or perhaps uncovering and disclosing the existence of contingent surrender charges, not a rarity with general account policies, which we believe constitute the bulk of BB&T's BOLI holdings).

Market Reverberations

Stable Value protection providers are reassessing their exposure to losses; not only due to the unanticipated severity in divergence of MV from BV from these isolated risky BOLI investments, but also to account for the unprecedented recent market upheaval. We anticipate, at least in the near-term, higher stable value fees, lower threshold triggers and less favorable overall contract terms.

We anticipate, at least in the near-term, higher stable value fees, lower threshold triggers and less favorable overall contract terms.

We will continue our efforts to learn more about the Wachovia and BB&T situations as they may be beneficial to readers. Needless to say, along with new details, we will include any clarifications or corrections to information previously reported.

If you would like to discuss this topic further, please contact either John Pfleger (jpfleger@coliaudit.com) or Matt Schoen (mbschoen@coliaudit.com).