
ACA-ASSURANCE INTEROFFICE MEMORANDUM

TO: BOARD OF DIRECTORS
FROM: HENRI R. BERSOUX
SUBJECT: FIRST QUARTER 2005
DATE: 5/26/05

OPERATIONS HIGHLIGHTS

You will find enclosed ACA's profit & loss report and balance sheet for the first quarter of 2005 as reported in our quarterly filing to the State of New Hampshire.

ACA grew its revenues by \$200,000 over the first quarter of 2004 for a total of \$6 million. The amount is \$2.6 lower than budgeted, reflecting primarily a delay of the sale of ACA's main investment property (\$1.5 million expected profit) and slower life sales than forecasted in the US (\$1.1 million). Because large forecasted sales were delayed, not cancelled, management maintains its outlook for the full year 2005.

Although management had expected a loss in the first quarter, ACA contributed almost \$600,000 to surplus. This is a \$2.8 million positive variance against budget. The reasons are largely as follows: decrease of over \$1 million in annuity reserves kept on the books long after the claim was paid; increase in investment income (even without the sale of the property) of almost \$500,000; lower than expected G&A expenses (\$500,000); lower than expected acquisition expenses.

Net operating income at 3/31/2005 was \$419,000, for a positive variance against forecast and budget.

Surplus at March 31, 2005 was \$11 million for an increase of 54% over the first quarter of 2004, and almost 6% over year end 2004.

Assets were not significantly higher than year end because ACA incurs most of the Tour+Med claims in the first quarter of the year and because ACA management has virtually ceased the sale of annuity products. Management expects to withdraw annuity products entirely in the second quarter.

The Tour+Med season experienced slower growth than in the prior season on slightly higher claims. Management has reviewed the season and made several adjustments. A final accounting of the Tour+Med season is done over the summer.

Board members have previously been made aware of issues related to the booking of the Assumption Reinsurance Treaty with Union Vie at December 31, 2004. Management has worked hard with both Canadian and American regulators and believes it is taking all steps necessary to finalize the transaction. In finalizing the purchase numbers with Union Vie some issues have arisen over the quality of the data involved and in particular individual guarantees that were given by prior management. Although these issues could increase the purchase price, management has reserved for this contingency. More will be known in the next thirty days.

MANAGEMENT FINANCIAL COMMENTS

1. ACA's auditors have completed a very thorough audit of the Society and have indicated they have no material concerns. They have provided management with a long list of requested changes to internal practices that date back decades. ACA management has no issues with the changes and/or corrections requested by the auditors and many of these changes were already implemented with the first quarter closing.
2. All investments of the Society are performing well and within the investment guidelines set by the Board of Directors with two exceptions. ACA recently experienced two "falling angels" in the form of investment grade bonds that were downgraded to "junk" status or non-investment grade. These are bonds of Ford Motor Company, General Motors and GMAC. Management does not see a default risk over the remaining life of these bonds and is keeping them in the portfolio.
3. Ironically, Ford and GM have requested that ACA obtain a financial strength rating from AM Best as relates to our sales of credit life products through their dealers. The rating has been requested.
4. Management has not yet adjusted the reserves for several plans that are calculated one year in advance. That is expected to occur in the second or third quarter of this year and should, barring unforeseen circumstances, contribute materially to surplus.

The Chief Financial Officer's report will have additional line-by-line commentary.

MANAGEMENT OPERATIONAL COMMENTS

1. Many sales in the United States pre-need market were delayed in the first quarter. ACA is encountering much more determined competition as we continue to acquire market share from banks, trusting companies and other sources.
2. The US sales pipeline is verifiably full of qualified opportunities due to close in the next 30-90 days. Management expects to meet the forecast for pre-need sales and exceed the forecast for traditional life products.
3. Pre-need products are expected to launch in the Western provinces of Canada in the third quarter of 2005.
4. Management expects to begin again the active marketing of credit life products in Canada on July 1, 2005.
5. Management expects to resubmit dynamic budgets and forecasts prior to the next Board meeting in August.

POTENTIAL THREATS

1. A significant terrorist event that curtails travel from Canada to the United States. This risk is not highly quantifiable.
2. A disaster affecting business continuity. Disaster planning and business continuity initiatives are expected to be completed by the end of summer and will significantly mitigate against this risk.

3. Loss of key sales personnel. This risk is being mitigated by the partitioning and expansion of sales personnel in the United States. In Canada, renewed efforts are planning for the second and third quarter to expand life sales in Ontario and the west of Canada.
4. Regulatory hurdles. This risk is being mitigated by the appointment of a senior officer to lead an expanded insurance and regulatory department.
5. Lack of approval for the GALIC transfer from Canadian or US authorities. Management believes this risk to be very low. A related risk would be higher expenses than expected as relate to the transfer.
6. Ability to expand geographically. More on this subject will be available in the second quarter report.