MML Bay State Life Insurance Company
Management's Discussion and Analysis
Of the 2008 Financial Condition and Results of Operations

General

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Audited Statutory Financial Statements, Notes to Statutory Financial Statements, and Statutory Annual Statements. This Management's Discussion and Analysis reviews the financial condition of MML Bay State Life Insurance Company (**"MML Bay State," "us," "we" or "our"**) as of December 31, 2008 and 2007, our results of operations for the past three years and, where appropriate, factors that may affect our future financial performance.

Together with our parent, C.M. Life Insurance Company (**"C.M. Life"**) and its parent, Massachusetts Mutual Life Insurance Company (**"MassMutual"**) and its subsidiaries, we are a growth-oriented, diversified financial services company that seeks to provide superior value for policyholders and other customers by achieving exceptional results. We are in the business of helping our customers achieve financial success while protecting their families and businesses. We are committed to maintaining a position of preeminent financial strength by achieving consistent and long-term profitable growth.

This will be accomplished by developing and distributing a broad and superior portfolio of innovative financial products and services, sophisticated asset/liability management, rigorous expense control, prudent underwriting standards, continued efforts to improve persistency and retention levels, and continued commitment to the high credit quality and disciplined diversification of our general account investment portfolio.

Our statutory net income was $10 million in 2008 and $11 million in 2007. As of and for the year ended December 31, 2008, we had $313 million in general account statutory assets, $4.2 billion in total statutory assets, 50,000 individual policies in force and $18.1 billion of life insurance in force. Our total adjusted capital, as defined by the National Association of Insurance Commissioners (the "**NAIC**"), increased to $192 million as of December 31, 2008 compared to $185 million as of December 31, 2007.

The following table sets forth the calculation of total adjusted capital:

	December 31, 2008	December 31, 2007
	(In Millions)	
Surplus (shareholders' equity)	$ 192	$ 183
Asset valuation reserve	-	2
One-half of the apportioned dividend liability	-	-
Total adjusted capital [1]	**$ 192**	**$ 185**

[1] Defined by the NAIC as surplus plus consolidated asset valuation reserve (**"AVR"**) and one-half of the consolidated apportioned dividend liability.

MML Bay State, C.M. Life and MassMutual's financial strength ratings are AAA (Extremely Strong) from Standard & Poor's, A++ (Superior) from A.M. Best Company, AAA (Exceptionally Strong) from Fitch Ratings, and Aa1 (Excellent) from Moody's Investors Service. Each rating agency independently assigns a rating based on its own separate review and takes into account a variety of factors in making its decision. Ratings are subject to change and there can be no assurance of the ratings that will be afforded to us in the future.

Financial strength ratings are based upon an independent review of MML Bay State and that of the industry in which we operate. A rating trigger refers to a contractual clause in our contracts requiring action by us or resulting in financial consequences in the event of a downgrade of our and/or MassMutual's financial strength rating below a specified level. As of December 31, 2008, two group life insurance contracts with combined account values of $311 million contained rating triggers. If MassMutual's or MML Bay State's financial strength ratings fall significantly, we are required to pursue the transfer of the risks of the contracts to another company.

As of December 31, 2008, there were no significant statutory or regulatory issues which would impair our financial position or liquidity, but there can be no assurance that such issues will not arise in the future. To the best of management's knowledge, we are not included on any regulatory or similar "watch list."

Forward-Looking Information

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements, which are identified as such and are accompanied by the identification of important factors, which could cause a material difference from the forward-looking statements.

Certain information contained in this discussion is or may be considered forward-looking. Forward-looking statements are those not based on historical information, but rather, relate to future operations, strategies, financial results or other developments, and contain terms such as "may," "expects," "should," "believes," "anticipates," "intends," "estimates," "projects," "goals," "objectives" or similar expressions.

Forward-looking statements are based upon estimates and assumptions. These statements may change due to business uncertainties, economic uncertainties, competitive uncertainties, and other factors, many of which are beyond our control. Additionally, our business decisions are also subject to change. We do not publicly update or revise any forward-looking statements as a result of new information, future developments or otherwise.

Results of Operations

The following table sets forth the components of statutory net income, for the periods presented:

	Years Ended December 31,				
	2008	2007	2006	% Change 08 vs. 07	% Change 07 vs. 06
	($ In Millions)				
Revenue:					
Premium income	$ 48	$ 51	$ 66	(6)%	(23)%
Net investment income	15	16	16	(6)	-
Reserve adjustments on reinsurance ceded	(17)	(17)	(14)	-	(21)
Fees and other income	87	94	87	(7)	8
Total revenue	133	144	155	(8)	(7)
Benefits and expenses:					
Policyholders' benefits	105	127	131	(17)	(3)
Change in policyholders' reserves	1	(33)	(36)	103	8
General insurance expenses	9	10	14	(10)	(29)
Commissions	5	5	5	-	-
State taxes, licenses and fees	2	2	2	-	-
Total benefits and expenses	122	111	116	10	(4)
Net gain from operations before federal income taxes	11	33	39	(67)	(15)
Federal income tax expense (benefit)	(3)	19	2	(116)	850
Net gain from operations	14	14	37	-	(62)
Net realized capital gains (losses), after tax and transfers to interest maintenance reserve	(4)	(3)	-	(33)	NM
Net income	**$ 10**	**$ 11**	**$ 37**	**(9)%**	**(70)%**

NM = not meaningful or in excess of 900%

Net income decreased $1 million in 2008 primarily due to a $34 million increase in change in policyholders' reserves, a $7 million decrease in fees and other income and a $3 million decrease in premium income, partially offset by decreases in policyholders' benefits of $22 million and federal income tax expense of $22 million.

Net income decreased $26 million in 2007 primarily due to a $15 million decrease in premium income, a $17 million increase in federal income tax expense and a $3 million increase in the change in policyholders' reserves, partially offset by a $7 million increase in fees and other income, a $4 million decrease in policyholders' benefits and a $4 million decrease in general insurance expenses.

Premium income includes considerations on life, annuity and bank-owned life insurance deposits. Premium income decreased $3 million in 2008 primarily due to a decrease in variable life insurance premium, partially offset by an increase in premium on bank-owned life insurance (**"BOLI"**) experience rated contracts. In 2007, premium income decreased $15 million primarily due to a decrease in variable life insurance premium and lower premium from experience rated contracts. Premium on variable life insurance has decreased as we no longer sell this product.

In 2008, net investment income, including the amortization of the IMR, decreased $1 million, or 6%, to $15 million from $16 million in 2007. Current year net investment income is primarily comprised of bonds of $8 million and policy loans of $5 million. In 2007, net investment income remained the same as 2006 at $16 million.

After deducting all investment expenses and including separate account net gains and interest maintenance reserve (**"IMR"**) amortization, the net annualized yields were 5.3% for the year ended December 31, 2008 and 5.6% for the year ended December 31, 2007. In 2008, yields on long and short-term bonds decreased while yields on mortgage loans and policy loans increased. We calculate the yield before federal income taxes as (a) gross investment income divided by (b) the monthly average of invested assets plus investment income due and accrued, net of foreign exchange adjustments, unrealized gains and losses, and investment-related liabilities, less half the gross investment income.

In 2008, fees and other income, which includes miscellaneous income and commissions and expense allowances on reinsurance ceded, decreased $7 million. The decrease was primarily driven by reduced asset based fees from separate accounts as a result of market value declines. In 2007, fees and other income increased $7 million primarily from growth in fees due to market appreciation on separate account assets.

Policyholders' benefits, which include supplementary contract payments, death, annuity, and surrender benefits, and interest and adjustments on contract or deposit-type contract funds, decreased $22 million in 2008 due to lower surrender benefits of $30 million, partially offset by higher death benefits on BOLI of $9 million. The decrease in surrender benefits was due to favorable experience on BOLI and variable annuity surrenders. While variable annuity account values have declined, variable annuity surrenders declined as contract holders tend to hold the variable annuity until the market becomes more favorable. In 2007, policyholders' benefits decreased $4 million due to lower surrender benefits. The decrease in surrender benefits was due in part to the surrender of a large contract in 2006.

The life insurance lapse rate, which is based on the amount of life insurance in force, was 6.7% in 2008 and 5.7% in 2007.

Change in policyholders' reserves, which includes transfers to and from separate accounts based upon policyholder elections and the change in general account reserves, increased $34 million in 2008 and $3 million in 2007. The increase in the change in policyholders' reserves in 2008 and 2007 was driven by lower surrenders.

General insurance expenses decreased $1 million and $4 million in 2008 and 2007, respectively. Expenses have decreased as no new products are being issued from MML Bay State. Additionally, expenses were favorably impacted in 2007 by the $1 million release of reserves related to a one-time class action settlement agreement regarding alleged insurance sales practice claims (the "**Global Settlement**").

Federal income tax expense decreased $22 million in 2008 primarily due to unfavorable IRS tax settlements in 2007 that did not recur and lower pretax earnings. Federal income tax expense increased $17 million in 2007 primarily due to a $14 million increase in expenses associated with IRS settlements upon completion of the 2001-2003 tax audit.

Net realized capital losses after taxes and IMR deferrals increased to a $4 million loss through December 31, 2008 from a loss of $3 million through December 31, 2007. The losses are driven by bond other-than-temporary impairments of $4 million for 2008 and $3 million for 2007 which are primarily attributed to the decline in value of residential mortgage-backed securities (**"RMBS"**).

The book values of investments are written down when a decline in value is considered to be other-than-temporary. We employ a systematic methodology to evaluate other-than-temporary impairments. The methodology to evaluate declines in value utilizes a quantitative and qualitative process ensuring that available evidence concerning the declines is evaluated in a disciplined manner. Pursuant to confirmation from the State of Connecticut Department of Insurance, we began utilizing undiscounted cash flows to determine impairments for structured securities prospectively beginning with the quarter ended September 30, 2008. Prior to July 1, 2008, resulting cash flows were discounted at spreads consistent with the structured and loan-backed security market's weakness and uncertainty around the magnitude and timing of cash flows. This review process provided a framework for deriving other-than-temporary impairments in a manner consistent with market participant assumptions. In these analyses, credit quality of loan vintage, collateral type and investment structure were critical elements of determining other-than-temporary impairments. As a result of this change, our total assets, net income and surplus for the year ended December 31, 2008 were not reduced by approximately $1 million.

In January 2009, the NAIC issued Statement of Statutory Accounting Principles (**"SSAP"**) No. 98, "Treatment of Cash Flows When Quantifying Changes in Valuation and Impairments, and Amendment of SSAP No. 43 – Loan-backed and Structured Securities," which is effective for quarterly and annual reporting periods beginning on or after January 1, 2009. SSAP No. 98 requires that a structured or loaned-backed security that is other-than-temporarily impaired be written down to fair value and recognized in net realized capital gains (losses). The estimated impact on total assets, net income and shareholder's equity of applying SSAP No. 98 as of December 31, 2008 of approximately $1 million resulting from RMBS and collateralized debt obligations (**"CDOs"**) as disclosed in the statutory financial statements represents management's best estimates and assumptions. The impact of applying SSAP No. 98 to other types of structured securities has not yet been determined, but may adversely impact the results of operations and financial condition.

Residential Mortgage-Backed Securities

As of December 31, 2008, we had $31 million of RMBS of which $10 million was prime, $12 million was Alt-A and $9 million was subprime. As of December 31, 2007, we had $47 million of RMBS of which $17 million was prime, $16 million was Alt-A and $14 million was subprime. The mortgages in these pools have varying risk characteristics and are commonly categorized as being of U.S. government agency, non-agency prime, Alt-A and subprime borrower quality. The mortgage collateral classified as U.S. government agency is considered of lowest relative risk while those classified as subprime are of the highest relative risk. The Alt-A category includes option adjustable rate mortgages and the subprime category includes "scratch and dent" or reperforming pools, high loan-to-value pools, and pools where the borrowers have very impaired credit but the average loan-to-value is low, typically 70% or below. In identifying Alt-A and subprime exposure, management utilized a combination of qualitative and quantitative factors, including FICO scores and loan-to-value ratios.

Beginning in 2007, market conditions for Alt-A and subprime investments deteriorated due to higher delinquencies, reduced home prices, and reduced refinancing opportunities. This market turbulence has spread to other credit markets. It is unclear how long it will take for a return to more liquid market conditions.

The actual cost, carrying value, fair value, and related gross realized losses from other-than-temporary impairments of our bond investments with significant Alt-A and subprime exposure were as follows:

	December 31, 2008			Year Ended December 31, 2008
	Actual Cost	**Carrying Value**	**Fair Value**	**Other-Than-Temporary Impairments**
		(In Millions)		
Alt-A	$ 13	$ 12	$ 8	$ (1)
Subprime	13	9	7	(2)
Total	**$ 26**	**$ 21**	**$ 15**	**$ (3)**

	December 31, 2007			Year Ended December 31, 2007
	Actual Cost	Carrying Value	Fair Value	Other-Than-Temporary Impairments
	(In Millions)			
Alt-A	$ 17	$ 16	$ 16	$ (1)
Subprime	15	14	13	(1)
Total	**$ 32**	**$ 30**	**$ 29**	**$ (2)**

The following tables show the percentage of statement value of Alt-A and subprime residential mortgage-backed securities by vintage (representing the year the pool of loans was originated) and credit ratings as of December 31, 2008 and 2007:

	December 31, 2008					
Year	**AAA**	**AA**	**A**	**BBB**	**BB & Below**	**Total**
2008	-%	-%	-%	-%	-%	-%
2007	3.8	4.7	-	1.3	3.4	13.2
2006	9.7	3.6	0.5	4.1	0.6	18.5
2005 & prior	51.1	14.3	1.9	1.0	-	68.3
Total	**64.6%**	**22.6%**	**2.4%**	**6.4%**	**4.0%**	**100.0%**

	December 31, 2007					
Year	**AAA**	**AA**	**A**	**BBB**	**BB & Below**	**Total**
2007	10.0%	3.3%	-%	-%	-%	13.3%
2006	16.7	3.3	-	-	-	20.0
2005 & prior	53.4	13.3	-	-	-	66.7
Total	**80.1%**	**19.9%**	**-%**	**-%**	**-%**	**100.0%**

Beginning in 2007, the slowing of the U.S. housing market, rising residential mortgage rates, and relaxed underwriting standards used by residential mortgage loan originators led to higher delinquency and loss rates, reduced credit availability and reduced liquidity in the residential loan market. We implemented a stringent review process for determining the nature and timing of other-than-temporary impairments on securities containing these risk characteristics. Cash flows were modeled for selected bonds deemed to be at risk for impairment using prepayment and default assumptions that varied according to collateral attributes. Bonds with nontrivial credit exposure were modeled across a variety of prepayment and default scenarios, spanning the range of possible outcomes specific to each individual security. Fair values resulting from internal models are those expected to be paid in an orderly transaction between willing market participants at the financial statement date.

Commercial Mortgage-Backed Exposure

We hold certain bonds backed by pools of commercial mortgages. The mortgages in these pools have varying risk characteristics related to underlying collateral type, borrower's risk profile and ability to refinance, and the return provided to the borrower from the underlying collateral. These investments had actual cost of $21 million, fair value of $17 million and no related gross realized losses from other-than-temporary impairments as of December 31, 2008. These investments had actual cost of $23 million, fair value of $23 million and no related gross realized losses from other-than-temporary impairments as of December 31, 2007.

Leveraged Loan Exposure

The current liquidity crisis has also resulted in increased risks related to our investments in domestic leveraged loans. Leveraged loans are loans extended to companies or individuals that already have considerable amounts of debt. We hold leveraged loans as bonds with interest rates that are higher than typical loans that reflect the additional risk of default from issuers with high debt-to-equity ratios. For the year ended December 31, 2008, we had domestic loan collateralized debt obligations (**"CDOs"**) with actual cost of $2 million, carrying value of $1 million, fair value of $1 million, and no related gross realized losses from other-than-temporary impairments. For the year ended December 31, 2007, we had domestic loan CDOs with actual cost of $2 million, carrying value of $1 million, fair value of $1 million, and related gross realized losses from other-than-temporary impairments of $1 million.

Management's judgment regarding other-than-temporary impairments and estimated fair value, including the difficulty of obtaining readily determinable prices impacted by the current illiquid credit market environment, for residential mortgage-backed investments and other investments depends upon evolving conditions that can alter the anticipated cash flows realized by investors. Further deterioration of market conditions and related management judgments of other-than-temporary impairments and fair value could negatively impact our statement of operations, surplus and disclosed fair value.

The fair values of RMBS and commercial mortgage-backed securities (**"CMBS"**) are highly sensitive to evolving conditions that can impair the cash flows realized by investors. Determining fair value is made more difficult by the lack of observable prices, uncertainty of credit ratings, and the current liquidity crisis which may continue into the foreseeable future. The ultimate emergence of losses is subject to uncertainty. If defaults were to increase above the stresses imposed in our analysis or collateral performance was worse than expected, management would need to reassess whether such credit events have changed our assessment of other-than-temporary impairments and estimates of fair values given the underlying dynamics of the market and the expected performance of these assets. A significant, unexpected credit event could change management's view of these assets. The liquidity crisis continues to adversely affect lenders' underwriting appetite for new financing arrangements and hence could lead to a diminished ability to refinance the underlying collateral. Also, continued down turns in the economy and real estate market and increased unemployment will likely result in higher defaults and ultimately, increased recognition of other-than-temporary impairments.

In response to the deterioration of CDOs backed by residential mortgage-backed securities in 2008 and 2007, the trading markets for all CDO-related structured products have been adversely affected by reduced liquidity. We have investments in CDOs that are exposed primarily to the credit risk of corporate bank loans, corporate bonds or credit default swap contracts referencing corporate credit risk. Most of these structured investments are backed by corporate loans and are commonly known as Collateralized Loan Obligations. The portfolios backing these investments are actively managed and diversified by industry and individual issuer concentrations. Due to the nature of CDOs which complicate an evaluation of the underlying collateral, the overall negative economic environment, and resulting reduced market liquidity, the risk premiums of CDOs have increased and resulted in declining prices. The steep decline in economic activity in the fourth quarter of 2008 will continue to affect the economic performance of the collateral pool of each CDO. Management believes its scenario analysis approach, based on actual collateral data, and forward looking assumptions does capture the level of default risks in each pool including refinancing risks. However, in a rapidly changing economic environment the risk in each collateral pool will be more volatile.

We have a review process for determining if CDO investments are at risk for other-than-temporary impairment. For the senior, mezzanine and junior debt tranches, cash flows are modeled using five scenarios based on the current ratings and prices of the underlying corporate credit risks and incorporated prepayment and default assumptions that vary according to collateral attributes of each transaction. The prepayment and default assumptions are varied within each model based upon rating (base case), historical expectations (default vector), rating change improvement (optimistic), rating change downgrade (pessimistic), and market price (market – implied). The default rates produced by these five scenarios are assigned an expectation weight according to current market and economic conditions and fed into a sixth scenario. An other-than-temporary impairment is recorded if the aggregate undiscounted projected cash flows, in this sixth scenario, result in the default of any principal or interest payments due. For the most subordinated non-coupon bearing junior tranches (CDO equity tranches), the present value of the projected cash flows, in the sixth scenario, are measured using an 11% discount rate. If the current book value of the security is greater than the present value measured using an 11% discount rate, then the sum of the undiscounted cash flows are compared to the book value. If the undiscounted cash flows do not equal or exceed the book value of the security, then an other-than-temporary impairment is taken in an amount sufficient to adjust the book value to the sum of undiscounted cash flows. Certain CDOs cannot be modeled using all six scenarios because of limitations on the data needed for all scenarios. The cash flows for these CDOs, including foreign denominated CDOs, are projected using a customized scenario management believes is appropriate for the applicable collateral pool.

Realized capital gains (losses) do not reflect the changes in the AVR and other investment reserves, which are recorded as a change in shareholders' equity.

Fluctuations in market conditions will impact future investment results.

Statement of Financial Position

The following table sets forth MML Bay State's assets, liabilities and shareholder's equity, for the dates presented:

	December 31, 2008	December 31, 2007	% Change 08 vs. 07
	($ In Millions)		
Assets:			
Bonds	$ 144	$ 175	(18)%
Mortgage loans	9	10	(10)
Policy loans	97	90	8
Derivatives and other invested assets	-	(1)	100
Cash, cash equivalents and short-term investments	36	(6)	700
Total invested assets	286	268	7
Investment income due and accrued	3	3	-
Insurance amounts receivable	6	6	-
Federal income taxes	13	14	(7)
Deferred income taxes	5	7	(29)
Total assets excluding separate accounts	313	298	5
Separate account assets	3,863	4,339	(11)
Total assets	**$ 4,176**	**$ 4,637**	**(10) %**
Liabilities and shareholder's equity:			
Policyholders' reserves	$ 108	$ 99	9%
Liabilities for deposit–type contracts	1	1	-
Contract claims and other benefits	14	21	(33)
General expenses due or accrued	-	4	(100)
Transfers due to (from) separate accounts	(12)	(25)	(52)
Payable to affiliate	3	3	-
Asset valuation reserve	-	2	(100)
Other liabilities	7	10	(30)
Total liabilities excluding separate accounts	121	115	5
Separate account liabilities	3,863	4,339	(11)
Total liabilities	3,984	4,454	(11)
Shareholder's equity	192	183	5
Total liabilities and shareholder's equity	**$ 4,176**	**$ 4,637**	**(10) %**

Assets

Total assets decreased $461 million, or 10%, in 2008 primarily due to decreases in separate account assets of $476 million and bonds of $31 million, partially offset by an increase in cash, cash equivalents and short-term investments of $42 million.

Bonds decreased $31 million, or 18%, in 2008, including $26 million of net dispositions and $4 million of other-than-temporary impairments. Bonds in NAIC Classes 1 and 2 were 48% of total invested general account assets as of December 31, 2008 and 63% as of December 31, 2007. The percentage of total invested assets representing bond investments in NAIC Classes 3 through 6 was 2% as of December 31, 2008 and 2007. There were $2 million of bonds in NAIC classes 5 and 6 as of December 31, 2008, and none as of December 31, 2007. See "Investments" for more discussion of NAIC investment classes.

Mortgage loans decreased $1 million, or 10%, in 2008 due to paydowns.

Policy loans increased $7 million, or 8%, in 2008 due to normal growth.

Cash, cash equivalents and short-term investments increased $42 million, or 700%, in 2008 to $36 million due to $26 million in net proceeds from bond sales, maturities or paydowns and $16 million of net investment income. In 2008, there was a decrease in dividends paid to C.M. Life of $37 million.

Deferred income taxes decreased $2 million in 2008 primarily due to Global Settlement claim payments and a reduction in future amortization of tax basis deferred acquisition costs. Upon payment of Global Settlement claims, a current tax benefit is recognized, releasing the deferred tax asset.

Separate account assets decreased $476 million, or 11%, primarily due to market depreciation of $365 million and negative net cash flows of $111 million.

Liabilities

Total liabilities decreased $470 million, or 11%, in 2008 primarily due to a decrease in separate account liabilities of $476 million, partially offset by a decrease in transfers due from separate accounts of $13 million.

Policyholders' reserves increased $9 million in 2008 primarily due to increases in variable life of $7 million and variable annuities of $3 million. Variable life reserves increased due to in force block growth. The increase in variable annuities is primarily due to increased guaranteed minimum death benefits (**"GMDB"**) of $3 million due to market value declines.

As a result of the precipitous drop in the U.S. stock markets this year, the net amounts at risk associated with variable annuity guarantees increased significantly from December 31, 2007 to December 31, 2008. These variable annuity guarantees are in the form of GMDB.

The following table summarizes the account values, net amount at risk and weighted average attained age for variable annuity contracts with guaranteed minimum death benefits classified as policyholders' reserves and separate account liabilities. The net amount at risk is defined as the minimum guarantee less the account value calculated on a policy-by-policy basis, but not less than zero.

	December 31, 2008			December 31, 2007		
	Account Value	Net Amount at Risk	Weighted Average Attained Age	Account Value	Net Amount at Risk	Weighted Average Attained Age
	($ In Millions)					
GMDB	$ 62	$ 40	64	$ 132	$ 9	67

Contract claims and other benefits decreased $7 million primarily due to fewer outstanding claims in 2008 compared to 2007, as well as a decrease in the average claim size.

General expenses due or accrued decreased $4 million in 2008 primarily due to payments related to the Global Settlement.

Transfers due from separate accounts decreased $13 million in 2008 primarily due to a decrease in the surrender charge receivable.

The AVR decreased $2 million in 2008, to $55 thousand from $2 million in 2007. The decrease was related to $4 million of net realized losses related to other-than-temporary impairments from bonds and preferred stocks, which were partially offset by a $2 million reserve contribution.

Other liabilities decreased $3 million in 2008. Other liabilities primarily include amounts payable on reinsurance, taxes, licenses and fees due or accrued, and remittances and items not allocated.

Shareholder's Equity ("Surplus")

The increase in surplus of $9 million in 2008 was primarily attributable to net income of $10 million and a decrease in the AVR of $2 million, partially offset by a $2 million decrease in net deferred income taxes.

Liquidity and Capital Resources

Liquidity

We manage our liquidity position by matching our exposure to cash demands with adequate sources of cash and other liquid assets. Our principal sources of liquidity are operating cash flows and holdings of cash, cash equivalents and other readily marketable assets. Our primary cash flow sources include investment income, principal repayments on invested assets and life insurance premium.

Cash, cash equivalents and short-term investments increased $42 million in 2008 to $36 million due to $26 million in net proceeds from bond sales, maturities or paydowns and $16 million of net investment income.

Net cash from operations decreased $12 million in 2008 primarily due to decreases in net transfers from separate accounts of $34 million and premium and other income collected of $19 million, partially offset by a decrease in federal income taxes paid of $33 million. Net cash from operations decreased $14 million in 2007 primarily due to a $24 million increase in federal income taxes paid, partially offset by a $7 million increase in net transfers from separate accounts.

Net cash from investments was $20 million in 2008, compared to an outflow of $4 million in 2007. Purchases of investments and the net increase in policy loans were $12 million in 2008 while sales and maturities of investments and receipts from repayments of loans were $32 million, resulting in a net cash inflow of $20 million. In 2007, purchases of investments and the net increase in policy loans were $58 million while sales and maturities of investments and receipts from repayments of loans were $54 million, resulting in a net cash outflow of $4 million.

The increase in net cash from financing and other sources of $41 million in 2008 was primarily due to a decrease in dividends paid to C.M. Life of $37 million. The decrease in net cash applied from financing and other sources of $4 million in 2007 was primarily due to a decrease in dividends paid to C.M. Life of $7 million.

Our investment portfolio is structured to ensure a strong liquidity position in order to permit timely payment of policy and contract benefits without requiring an uneconomic sale of assets. In general, liquid assets include cash and cash equivalents and public bonds, all of which generally have ready markets with large numbers of buyers. The statement value of these assets as of December 31, 2008 was approximately $138 million. While the investment portfolio does contain assets (primarily mortgage loans, other invested assets and private bonds) which are generally considered illiquid for liquidity monitoring purposes, there is some ability to raise cash from these assets if needed.

We utilize sophisticated asset/liability analysis techniques in the management of the investments supporting our liabilities. Additionally, we test the adequacy of the projected cash flow provided by assets to meet all of our future policyholder and other obligations. We perform these studies using stress tests regarding future credit and other asset losses, market interest rate fluctuations, claim losses, and other considerations. The result is a complete picture of the adequacy of our underlying assets, reserves, and capital. We analyze a variety of scenarios modeling potential demands on liquidity, taking into account the provisions of our policies and contracts in force, our cash flow position, and the volume of cash and readily marketable securities in our portfolio. We proactively manage our liquidity position on an ongoing basis to meet cash needs while minimizing adverse impacts on investment returns.

Capital Resources

As of December 31, 2008 and 2007, our total adjusted capital as defined by the NAIC was $192 million and $185 million, respectively. The NAIC has a Risk Based Capital (**"RBC"**) model to compare total adjusted capital with a standard design in order to reflect an insurance company's risk profile. Although we believe that there is no single appropriate means of measuring RBC needs, we feel that the NAIC approach to RBC measurement is reasonable, and we manage our capital position with significant attention to maintaining adequate total adjusted capital relative to RBC. We believe that we enjoy a strong capital position in light of our risks and that we are well positioned to meet policyholder and other obligations.

Investments

General

As directed by our policyholders, approximately 93% of our assets as of December 31, 2008 are separate account assets. Separate account assets consist principally of marketable securities reported at fair value and are not available to satisfy liabilities that arise from any of our other businesses. The following discussion focuses on the general investment account portfolio, which does not include our separate account assets.

As of December 31, 2008 and 2007, we had $286 million and $268 million, respectively, of invested assets in our general investment account. We manage the portfolio of invested assets to support the general account liabilities of the business in light of yield, liquidity and diversification considerations.

The following table sets forth our invested assets in the general account as of the dates indicated:

	December 31,			
	2008		2007	
	Carrying Value	% of Total	Carrying Value	% of Total
	($ in Millions)			
Bonds	$ 144	50%	$ 175	65%
Mortgage loans	9	3	10	4
Policy loans	97	34	90	33
Derivatives and other invested assets	-	-	(1)	-
Cash, cash equivalents and short-term investments	36	13	(6)	(2)
Total investments	**$ 286**	**100%**	**$ 268**	**100%**

NM = not meaningful or in excess of 900%

The following table is a management view of the general account's earnings yields by asset type:

	December 31,	
	2008	2007
Long and short-term bonds	5.1%	5.6%
Preferred stocks	9.0	-
Mortgage loans	6.4	6.2
Policy loans	5.8	5.7
Derivatives	NM	NM
Total Portfolio	**5.3%**	**5.6%**

NM = not meaningful or in excess of 900%

Bonds, Cash Equivalents and Short-Term Investments

Bonds consist primarily of government securities, mortgage-backed securities and high quality marketable corporate debt securities. We invest a significant portion of our investment funds in high quality publicly traded bonds in order to maintain and manage liquidity and reduce the risk of default in the portfolio.

The NAIC Securities Valuation Office (**"SVO"**) rates investment credit risk based upon the issuer's credit profile. NAIC rating designations range from 1 to 6. An NAIC designation of 1 denotes obligations of the highest quality in which credit risk is at its lowest and the issuer's credit profile is stable, whereas an NAIC designation of 6 is assigned to obligations that are in or near default. Classes 1 and 2 are investment grade, Class 3 is medium quality and Classes 4, 5 and 6 are non-investment grade.

The following table sets forth the SVO ratings for our portfolio along with what we believe are the equivalent rating agency designations. Our presentation consists of long-term bonds, short-term securities and cash equivalents. The tables below also set forth the NAIC SVO ratings for our publicly traded and privately placed portfolios.

Total Portfolio Credit Quality

		December 31,			
		2008		2007	
NAIC Classes	Rating Agency Equivalent Designation	Carrying Value	% of Total	Carrying Value	% of Total
		($ In Millions)			
1	Aaa/Aa/A	$ 82	46%	$ 109	59%
2	Baa	94	52	71	38
3	Ba	3	2	5	3
4	B	1	-	1	-
5	Caa and lower	1	-	-	-
6	In or near default	1	-	-	-
	Total	**$ 182**	**100 %**	**$ 186**	**100 %**

Publicly Traded Credit Quality

		December 31,			
		2008		2007	
NAIC Classes	Rating Agency Equivalent Designation	Carrying Value	% of Total	Carrying Value	% of Total
		($ In Millions)			
1	Aaa/Aa/A	$ 68	50%	$ 89	65%
2	Baa	68	50	45	32
3	Ba	1	-	4	3
4	B	1	-	1	-
5	Caa and lower	1	-	-	-
6	In or near default	1	-	-	-
	Total	**$ 140**	**100 %**	**$ 139**	**100 %**

Privately Placed Credit Quality

		December 31,			
		2008		2007	
NAIC Classes	Rating Agency Equivalent Designation	Carrying Value	% of Total	Carrying Value	% of Total
		($ In Millions)			
1	Aaa/Aa/A	$ 14	34%	$ 20	43%
2	Baa	26	62	26	55
3	Ba	2	4	1	2
	Total	**$ 42**	**100 %**	**$ 47**	**100 %**

We utilize our investments in the privately placed portfolio to enhance the value of the overall portfolio, increase diversification, and obtain higher yields than can be earned by investing in comparable quality public market securities. To control risk when utilizing privately placed securities, we rely upon broader access to management information, stronger negotiated protective covenants, call protection features, and a higher level of collateralization than can customarily be achieved in the public market. The strength of the privately placed portfolio is demonstrated by the predominance of NAIC Class 1 and 2 securities.

The following table sets forth by industry category the total bond portfolio, including short-term securities and cash equivalents, as of December 31, 2008:

Portfolio by Industry
December 31, 2008

Industry Category	Public Carrying Value	Public % of Total	Private Carrying Value	Private % of Total	Total Carrying Value	Total % of Total
	($ In Millions)					
Mortgage-backed securities	$ 43	31%	$ 1	2%	$ 44	24%
Cash equivalent and short-term investments	38	27	-	-	38	21
Utilities	11	8	7	17	18	10
Finance	10	7	6	15	16	9
Capital goods	5	4	9	21	14	8
Asset-backed securities	8	6	5	12	13	7
Consumer services	5	3	6	15	11	6
Natural resources	4	3	2	5	6	3
Media	5	4	1	2	6	3
Government	5	3	-	-	5	3
Consumer goods	2	1	1	2	3	2
Transportation	-	-	3	7	3	2
Healthcare	2	1	-	-	2	1
Technology	1	1	1	2	2	1
Retail	1	1	-	-	1	-
Total	**$ 140**	**100%**	**$ 42**	**100%**	**$ 182**	**100%**

Mortgage-backed securities consist mainly of residential mortgage-backed securities and collateralized mortgage obligations. We do not originate any residential mortgages but invest in residential mortgage loan pools which may contain mortgages of subprime credit quality.

Only one other industry group other than mortgage-backed securities, cash equivalents and short-term investments, exceeds 10% of the total bond portfolio.

Bond Portfolio Surveillance and Under-Performing Investments

Generally, bonds are valued at amortized cost using the constant yield interest method. Bond transactions are recorded on a trade date basis, except for private placement bonds which are recorded on the funding date.

For fixed income securities that do not have a fixed schedule of payments, such as asset-backed, mortgage-backed and structured securities, the effect on amortization or accretion is revalued quarterly based on the current estimated cash flows, using either the prospective or retrospective adjustment methodologies, consistently applied by type of security. Certain high quality fixed income securities follow the retrospective method of accounting. Under the retrospective method, the recalculated effective yield equates the present value of the actual and anticipated cash flows, including new prepayment assumptions, to the original cost of the investment. Prepayment assumptions are based on borrower constraints and economic incentives such as the original term, age and coupon of the loan as affected by the interest rate environment. The current carrying value is then increased or decreased to the amount that would have resulted had the revised yield been applied since inception, and investment income is correspondingly decreased or increased. We elected to use the book value as of January 1, 1994 as the cost for applying the retrospective adjustment method to securities purchased prior to that date. All other fixed securities, such as floating rate bonds and interest only securities, follow the prospective method of accounting. Under the prospective method, the recalculated future effective yield equates the carrying value of the investment to the present value of the anticipated future cash flows.

The fair value of bonds is based on values provided by the NAIC's Securities Valuation Office (**"SVO"**) when available. If SVO values are not available, quoted market values provided by other third-party organizations are used. If quoted market values are unavailable, fair value is estimated using internal models by discounting expected future cash flows using current market rates applicable to yield, credit quality and maturity of the investment or using quoted market values for comparable investments. Internal inputs used in the determination of fair value include estimates of prepayment speeds, default rates, discount rates, and collateral values, among others. Structure characteristics and results of cash flow priority are also considered. Fair values resulting from internal models are those expected to be paid in an orderly transaction between willing market participants at the financial statement date.

To identify under-performing investments, we employ a systematic methodology to evaluate other-than-temporary impairments by conducting a quarterly management review of all bonds including those in default, not-in-good standing, or valued below 80% of cost. We consider the following factors in the evaluation of whether a non-interest related decline in value is other-than-temporary: (a) the financial condition and near-term prospects of the issuer; (b) the likelihood that we will be able to collect all amounts due according to the contractual terms of the debt security in effect at the date of acquisition or expected cash flow for a structured security; (c) our ability and intent to hold the investment for a period of time sufficient to allow for an anticipated recovery in value; and (d) the period and degree to which the market value has been below cost. We consider the following factors in the evaluation of whether an interest related decline in value is other-than-temporary: (a) our near-term intent to sell; (b) our contractual and regulatory obligations; and (c) our ability and intent not to sell the investment until anticipated recovery of the cost of the investment. We also consider other qualitative and quantitative factors in determining the existence of other-than-temporary impairments including, but not limited to, unrealized loss trend analysis and significant short-term changes in value. If the impairment is other-than-temporary, a direct write-down to fair value or, for structured securities including residential mortgage-backed securities (**"RMBS"**) after July 1, 2008, to a value determined using undiscounted cash flows is recognized in realized capital losses and a new cost basis is established.

We have a review process for determining if Collateralized Debt Obligation (**"CDO"**) investments are at risk for other-than-temporary impairment. For the senior and junior debt tranches, cash flows are modeled using five scenarios based on the current ratings and prices of the underlying corporate credit risks and incorporated prepayment and default assumptions that vary according to collateral attributes of each deal. The prepayment and default assumptions are varied within each model based upon rating (base case), historical expectations (default vector), rating change improvement (optimistic), rating change downgrade (pessimistic), and market price (market – implied). The default rates produced by these five scenarios are assigned an expectation weight according to current market and economic conditions and fed into a sixth scenario. An other-than-temporary impairment is recorded if the aggregate undiscounted projected cash flows in this sixth scenario result in the default of any principal or interest payments due. For the most subordinated non-coupon bearing junior tranches (CDO equity tranches), the present value of the projected cash flows, in the sixth scenario are measured using an 11% discount rate. If the current book value of the security is greater than the present value measured using an 11% discount rate, then the sum of the undiscounted cash flows are compared to the book value. If the undiscounted cash flows do not equal or exceed the book value of the security, then an other-than-temporary impairment is taken in an amount sufficient to adjust the book value to the sum of undiscounted cash flows. Certain CDOs cannot be modeled using all six scenarios, because of limitations on the data needed for all scenarios. The cash flows for these CDOs, including foreign denominated CDOs, are projected using a customized scenario management believes is appropriate for the applicable collateral pool.

Asset-backed securities, including RMBS and commercial mortgage-backed securities (**"CMBS"**), are evaluated for other-than-temporary impairment on a periodic basis using scenarios customized by collateral type. We perform sensitivity analysis on defaults as loan-to-value ratios change, and on defaults as prepayments change using default curves under various scenarios. We combine scenario analysis with a monthly surveillance process in which we compare actual delinquencies and defaults to expectations established at the time securities are acquired and expectations considering current market conditions, and perform a statistical review to determine potential losses relative to credit support of troubled loan exposures on a transaction-by-transaction basis.

Pursuant to confirmation from the State of Connecticut Department of Insurance, we began utilizing undiscounted cash flows to determine other-than-temporary impairments for structured securities, prospectively beginning with the quarter ended September 30, 2008. Internal inputs used in determining the amount of the other-than-temporary impairments on structured securities included collateral performance including prepayment speeds, default rates, and loss severity based on borrower and loan characteristics, as well as deal structure including subordination, over-collateralization and cash flow priority. Prior to July 1, 2008, resulting cash flows were discounted at spreads consistent with the residential mortgage market's weakness and the uncertainty around the magnitude and timing of cash flows. This review process provided a framework for deriving other-than-temporary impairments in a manner consistent with market participant assumptions. In these analyses, credit quality by loan vintage, collateral type and investment structure were critical elements in determining other-than-temporary impairments.

We actively review the bond portfolio to estimate the likelihood and amount of financial defaults or write-downs in the portfolio and to make timely decisions as to the potential sale or renegotiation of terms of specific investments.

The NAIC defines under-performing bonds as those whose deferral of interest and/or principal payments are deemed to be caused by the inability of the obligor to make such payments as called for in the bond contract.

As of December 31, 2008 there were $1 million of bonds with NAIC Class 6 ratings and none in 2007.

The following is an analysis of the gross unrealized losses aggregated by bond category and length of time that the securities were in a continuous unrealized loss position.

	December 31, 2008					
	Less than 12 months			12 Months or longer		
	Fair Value	Unrealized Losses	Number of Issuers	Fair Value	Unrealized Losses	Number of Issuers
	($ In Millions)					
U. S. government	$ -	$ -	1	$ -	$ -	-
Special revenue	1	-	2	1	-	1
Public utilities	9	1	28	1	-	5
Industrial and miscellaneous	62	8	145	33	10	86
Total	**$ 72**	**$ 9**	**176**	**$ 35**	**$ 10**	**92**

The following is an analysis of the gross unrealized losses aggregated by bond category, length of time that the securities have been in a continuous unrealized loss position and investment grade.

	December 31, 2008					
	Less than 12 months			12 Months or longer		
	Investment Grade	Below Investment Grade	Total	Investment Grade	Below Investment Grade	Total
	($ in Millions)					
Public utilities	$ 1	$ -	$ 1	$ -	$ -	$ -
Industrial and miscellaneous	8	-	8	9	1	10
Total	**$ 9**	**$ -**	**$ 9**	**$ 9**	**$ 1**	**$ 10**

For industrial and miscellaneous, the majority of the unrealized losses in both categories above continued to grow as the widening of credit spreads, the continuing decline in the credit markets, liquidity, bank loan values, and other uncertainties were reflected in current market values. These factors continue to impact the value of RMBS bonds and have now spread to the broader bond market significantly affecting values in leveraged loans and CMBS. Deterioration of underlying collateral, downgrades of credit ratings, or other factors may lead to further declines in value.

Based on our policy, as of December 31, 2008, we did not deem these investments to be other-than-temporarily impaired because the book value of the investments is expected to be realized based on our analysis of fair value or, in the case of structured securities, undiscounted cash flows, and we have the ability and intent not to sell theses investments until recovery, which may be at maturity.

Mortgage Loans

Mortgage loans represented 3% of the total investments in the general account as of December 31, 2008. Mortgage loans consist of whole loans on commercial real estate and residential mortgage loan pools. As of December 31, 2008, we had no commercial loans in our mortgage loan portfolio.

Residential Mortgage Loans

We do not originate any residential mortgages but invest in residential mortgage loan pools which may contain mortgages of subprime credit quality. As of December 31, 2008 and 2007, we had no direct subprime exposure through the origination of residential mortgage loans or purchases of unsecuritized whole-loan pools. We purchase seasoned loan pools, most of which are FHA insured and VA guaranteed. As of December 31, 2008, we had mortgages with residential mortgage-backed exposure with a carrying value of $9 million, most of which were FHA insured or VA guaranteed.

These investments have provided excellent loss/risk experience. We impose rigorous investment standards focusing on governmental agency guarantees and seasoning. We also apply rigorous prepayment analysis as appropriate for each of these investments.

Mortgage Loan Portfolio Surveillance and Under-Performing Investments

We perform or review all aspects of loan origination and portfolio management, including lease analysis, property transfer analysis, economic and financial reviews, tenant analysis, and management of default and bankruptcy proceedings.

We re-value under-performing properties each year and re-inspect these properties at least every other year based on internal quality ratings. The criteria used to determine whether a current or potential problem exists includes borrower bankruptcies, major tenant bankruptcies, requests for restructuring, delinquent tax payments, late payments, loan-to-value or debt service coverage deficiencies, and overall vacancy levels.

There were no current and potential problem mortgage loans consisting of restructured mortgage loans as of December 31, 2008 or 2007, and no mortgage loans in default as of December 31, 2008 or 2007. The AVR contains a mortgage loan component, which totaled $55 thousand and $61 thousand as of December 31, 2008 and 2007, respectively. See "Investment Reserves."

Investment Reserves

We establish and record appropriate write-downs or investment reserves in accordance with statutory practice.

We determine the fair value of bonds in accordance with principles established by the SVO using criteria that include the net worth and capital structure of the borrower, the value of the collateral, the presence of additional credit support, and our evaluation of the borrower's ability to compete in a relevant market.

In compliance with regulatory requirements, we maintain an AVR. The AVR is a contingency reserve to offset potential losses of stocks, real estate investments, partnerships and limited liability companies (**"LLCs"**), as well as credit-related declines in bonds, mortgage loans, and derivatives.

As of December 31, 2008, the AVR totaled $55 thousand, which represents a 97% decrease from December 31, 2007. This decrease is primarily due to the decrease in statement value of bonds and current year after-tax realized capital losses of $4 million related to other-than-temporary impairments.

Quantitative and Qualitative Information about Market Risk

All non-guaranteed separate account assets and liabilities have been excluded from the following discussion since all market risks associated with those accounts are assumed by the contract holders.

Assets, such as bonds, stocks, mortgage loans, policy loans and derivatives are financial instruments, which are subject to the risk of market volatility and potential market disruptions. These risks may reduce the value of our financial instruments, or impact future cash flows and earnings from those instruments. We do not hold or issue any financial instruments for the purpose of trading.

We have market risk exposure to changes in interest rates, which can cause changes in the fair value, cash flows, and earnings of certain financial instruments. To manage our exposure to interest rate changes, we use sophisticated quantitative asset/liability management techniques. Through asset/liability management we match the market sensitivity of assets with the liabilities they support. If these sensitivities are closely matched, the impact of interest rate changes is effectively offset on an economic basis as the change in value of the asset is offset by a corresponding change in the value of the supported liability. In addition, we invest a significant portion of our investment funds in high quality bonds in order to maintain and manage liquidity and reduce the risk of default in the portfolio.

Based upon the information and assumptions we used in our asset/liability analysis as of December 31, 2008, we estimate that a hypothetical immediate 10% increase in the 10-year treasury rate, approximately twenty-one (21) basis points, would decrease the net fair value of our financial instruments by $1 million. Whereas, a hypothetical immediate 10% decrease in the rate would increase the net fair value of our financial instruments by $1 million. A significant portion of our liabilities, such as insurance policy and claim reserves, are not considered financial instruments and are excluded from the above analysis. Because of our asset/liability management, a corresponding change in fair values of these liabilities, based on the present value of estimated cash flows, would significantly offset the net change in fair value of assets estimated above.

Revenues and profitability from variable products will vary from period to period, driven in part by changes in the capital and equity markets. Specifically, certain fees we charge for variable annuity product separate accounts are based on the separate account asset levels. Separate account asset levels change as the underlying investments' market values change. Based on our experience, management believes that a 10% change in the equity markets would change the annualized fees by less than $1 million.

We offer secondary guarantees with substantially all new annuity products primarily in the form of guaranteed minimum death benefits (**"GMDB"**). The profitability of these products can also vary as our obligation related to secondary guarantees changes with capital and equity market volatility. The liability for GMDB was $3 million as of December 31, 2008. We paid $1 million for GMDB in the year ended December 31, 2008. There were no payments for other secondary guarantees during 2008. We assess the risks associated with secondary guarantees in the overall context of risk management, but do not reinsure the risks associated with secondary guarantees.

Risks related to credit markets

Credit risk is the risk that issuers of investments owned by us may default or that other parties may not be able to pay amounts due to us. We attempt to manage our investments to limit credit risk by diversifying our portfolio among various security types and industry sectors.

Beginning in 2007, the slowing of the U.S. housing market, rising residential mortgage rates, and relaxed underwriting standards by residential mortgage loan originators led to higher delinquency and loss rates, reduced credit availability and reduced liquidity in the residential loan market. We have implemented a stringent review process for determining the nature and timing of other-than-temporary impairments on securities containing these risk characteristics. Cash flows were modeled for selected bonds deemed to be at risk for impairment using prepayment and default assumptions that varied according to collateral attributes. Bonds with nontrivial credit exposure were modeled across a variety of prepayment and default scenarios, spanning the range of possible outcomes specific to each individual security. Fair values resulting from internal models are those expected to be paid in an orderly transaction between market participants at the financial statement date.

The fair values of RMBS and CMBS are highly sensitive to evolving conditions that can impair the cash flows realized by investors. Determining fair value is made more difficult by the lack of observable prices, uncertainty of credit ratings, and the current liquidity crisis which may continue into the foreseeable future. The ultimate emergence of losses is subject to uncertainty. If defaults were to increase above the stresses imposed in our analysis or collateral performance was worse than expected, management would need to reassess whether such credit events have changed our assessment of other-than-temporary impairments and estimates of fair values given the underlying dynamics of the market and the expected performance of these assets. A significant, unexpected credit event could change management's view of these assets. The liquidity crisis continues to adversely affect lenders' underwriting appetite for new financing arrangements and hence could lead to a diminished ability to refinance the underlying collateral. Also, continued down turns in the economy and real estate market and increased unemployment will likely result in higher defaults and ultimately, increased recognition of other-than-temporary impairments.

In response to the deterioration of Collateralized Debt Obligations (**"CDOs"**) backed by residential mortgage-backed securities in 2008 and 2007, the trading markets for all CDO-related structured products have been adversely affected by reduced liquidity. We have investments in CDOs that are exposed primarily to the credit risk of corporate bank loans, corporate bonds or credit default swap contracts referencing corporate credit risk. Most of these structured investments are backed by corporate loans and are commonly known as Collateralized Loan Obligations. The portfolios backing these investments are actively managed and diversified by industry and individual issuer concentrations. Due to the nature of CDOs which complicate an evaluation of the underlying collateral, the overall negative economic environment, and resulting reduced market liquidity, the risk premium of CDOs have increased and resulted in declining prices. The steep decline in economic activity in the fourth quarter of 2008 will continue to affect the economic performance of the collateral pool of each CDO. Management believes its scenario analysis approach, based on actual collateral data and forward looking assumptions, does capture the level of default risks in each pool including refinancing risks. However, in a rapidly changing economic environment the risk in each collateral pool will be more volatile.

The current liquidity crisis has also resulted in increased risks related to our investments in domestic leveraged loans. While default rates were low in 2007 and 2008, the weakening of world credit markets may have negative consequences in the future. In addition, the liquidity crisis continues to adversely affect lenders' underwriting appetite for new financing arrangements and hence could lead to a diminished ability to refinance the underlying collateral which could lead to increased defaults.

Management's judgment regarding other-than-temporary impairments and estimated fair value, including the difficulty of obtaining readily determinable prices impacted by the current illiquid credit market environment, for RMBS and other investments including leveraged loan exposure, depends upon evolving conditions that can alter the anticipated cash flows realized by investors. Further deterioration of market conditions and related management judgments of other-than-temporary impairments and fair value could negatively impact our results of operations, shareholder's equity and the disclosed fair value.

Continuing Market Impact

As of December 31, 2008, impairments were expected to be approximately $1 million related to residential mortgage-backed securities and collateralized debt obligations as a result of the first quarter 2009 implementation of the use of discounted cash flows in connection with SSAP No. 98, "Treatment of Cash Flows When Quantifying Changes in Valuations and Impairments, and Amendment to SSAP No. 43 – Loan–backed and Structured Securities." The impact of applying SSAP No. 98 to other types of structured securities has not yet been determined, but may adversely impact the results of operations and financial condition. Assets, such as bonds, stocks, mortgage loans on real estate, policy loans and derivatives are financial instruments, which are subject to the risk of market volatility and potential market disruptions. Subsequent to December 31, 2008, overall markets have fallen, risk spreads have widened and volatility has increased. Continued deterioration of market conditions may cause increased impairments and declines in our asset valuations, which in turn, may result in further impairments beyond those estimated pursuant to the implementation of SSAP No. 98.