



STATE OF NEW YORK INSURANCE DEPARTMENT
REPORT ON EXAMINATION
OF THE
FARMERS AND TRADERS LIFE INSURANCE COMPANY

CONDITION:

DECEMBER 31, 2004

DATE OF REPORT:

AUGUST 26, 2005

STATE OF NEW YORK INSURANCE DEPARTMENT
REPORT ON EXAMINATION
OF THE
FARMERS AND TRADERS LIFE INSURANCE COMPANY
AS OF
DECEMBER 31, 2004

DATE OF REPORT:

AUGUST 26, 2005

EXAMINER:

FLORA EGBUCHULAM

TABLE OF CONTENTS

<u>ITEM</u>	<u>PAGE NO.</u>
1. Executive summary	2
2. Scope of examination	4
3. Description of Company	5
A. History	5
B. Subsidiary	5
C. Management	7
D. Territory and plan of operation	10
E. Reinsurance	11
4. Significant operating results	12
5. Financial statements	15
A. Assets, liabilities and surplus	15
B. Condensed summary of operations	17
C. Surplus account	19
6. Market conduct activities	20
A. Advertising and sales activities	20
B. Underwriting and policy forms	26
C. Treatment of policyholders	26
7. Privacy and safeguarding	31
8. Internal audit	35
9. Investment policies and procedures	36
10. Remittances and items not allocated	38
11. Record retention plan	39
12. Disaster recovery and business continuity plans	40
13. Prior report summary and conclusions	42
14. Summary and conclusions	43



STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

George E. Pataki
Governor

Howard Mills
Superintendent

August 26, 2005

Honorable Howard Mills
Superintendent of Insurance
Albany, New York 12257

Sir:

In accordance with instructions contained in Appointment No. 22338, dated March 7, 2005 and annexed hereto, an examination has been made into the condition and affairs of Farmers and Traders Life Insurance Company, hereinafter referred to as "the Company," at its home office located at 960 James Street, Syracuse, New York 13203.

Wherever "Department" appears in this report, it refers to the State of New York Insurance Department.

The report indicating the results of this examination is respectfully submitted.

1. EXECUTIVE SUMMARY

The examiner's review of a sample of transactions did not reveal any differences which materially affected the Company's financial condition as presented in its financial statements contained in the December 31, 2004 filed annual statement. (See item 5 of this report)

The Company violated multiple sections of Department Regulation No. 60 by failing to: provide revised Disclosure Statements in instances where the policy that was issued differed from the policy that was applied for; review Disclosure Statements to ascertain that they were accurate and met the requirements of the Regulation; maintain copies of the Important Notice and Disclosure Statement; and reject applications where the required Important Notice and/or Disclosure Statement forms were not received with the application. (See item 6A of this report)

The Company violated Section 53-3.5(a) of Department Regulation No. 74 by failing to provide and obtain a signed receipt for the basic illustration that was used during the sales process when an electronic illustration was used to satisfy preliminary information requirements for policies being marketed with an illustration. (See item 6C of this report)

The Company violated several parts of Section 3209 of the New York Insurance Law by failing to: provide preliminary information; disclose the policy loan interest rate; and inform the applicant in writing of the option to return the policy for an unconditional refund of premiums paid up to ten days after receipt of the policy and the policy summary. (See item 6C of this report)

The Company does not have written agreements with some of its Third Party Administrators ("TPAs") and, as a result, it is unclear how privacy and safeguarding of nonpublic personal consumer financial and health information that is shared with those third parties is handled. The examiner makes several recommendations regarding the safeguarding of the Company's policyholders' and customers' nonpublic personal financial and health information by the Company's TPAs. (See item 7 of this report)

The Company violated Section 3203(a)(16) of the New York Insurance Law by failing to include a statement on its policy data or specifications page for policy form no. 8787 that additional amounts are not guaranteed and further, that the insurer has the right to change the amount of interest credited to the policy and the amount of cost of insurance or other expense charges deducted under the policy which may require more premium to be paid than what was

illustrated or the cash values may be less than those illustrated. The examiner recommends that the Company develop and submit an endorsement for the Department's approval that will be sent to the affected policyholders. (See item 6C of this report)

The examiner recommends that the Company establish and maintain an independent, adequately resourced, and competently staffed internal audit function to provide management and the independent directors committee (finance/audit committee) with ongoing assessments of the Company's risk management processes and the accompanying system of internal control. (See item 8 of this report)

The Company does not have a formal board approved policy (or guidelines) with regard to the process and procedures currently in place for the monitoring and determination of impaired securities. In addition, the Company's investment policy is lacking in certain other areas. The examiner makes several recommendations about the Company's investment policy regarding guidelines, limits, and board approval of the policy. (See item 9 of this report)

The examiner recommends that the Company revise its record retention plan to include an index containing the types of records being retained, the method of retention, and the safeguards established to prevent alteration of the records. (See item 10 of this report)

The examiner recommends that the Company continue its disaster recovery planning and business continuity efforts by developing formal, written plans that are tested on a regular basis. (See item 12 of this report)

2. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 2001. This examination covers the period from January 1, 2002 through December 31, 2004. As necessary, the examiner reviewed transactions occurring subsequent to December 31, 2004 but prior to the date of this report (i.e., the completion date of the examination).

The examination comprised a verification of assets and liabilities as of December 31, 2004 to determine whether the Company's 2004 filed annual statement fairly presents its financial condition. The examiner reviewed the Company's income and disbursements necessary to accomplish such verification and utilized the National Association of Insurance Commissioners' Examiners Handbook or such other examination procedures, as deemed appropriate, in such review and in the review or audit of the following matters:

- Company history
- Management and control
- Corporate records
- Fidelity bond and other insurance
- Officers' and employees' welfare and pension plans
- Territory and plan of operation
- Market conduct activities
- Growth of Company
- Business in force by states
- Mortality and loss experience
- Reinsurance
- Accounts and records
- Financial statements

The examiner reviewed the corrective actions taken by the Company with respect to the recommendation and violation contained in the prior report on examination. The results of the examiner's review are contained in item 13 of this report.

This report on examination is confined to financial statements and comments on those matters which involve departure from laws, regulations or rules, or which require explanation or description.

3. DESCRIPTION OF COMPANY

A. History

The Company was incorporated as a stock life insurance company under the laws of New York on July 3, 1912, was licensed and commenced business on July 7, 1914 with the name Farmers National Insurance Company. The present name was adopted on September 17, 1914.

On October 8, 1953, the board of directors of the Company recommended a plan of mutualization of the Company pursuant to Section 199 of the New York Insurance Law (now Section 7302). The plan provided for the purchase of all outstanding shares of stock at \$1,000 per share. The Company became a mutual life insurance company on December 20, 1974.

Pursuant to Section 1307 of the New York Insurance Law, the Company received approval for, and issued a surplus note in the amount of \$4 million on May 31, 2000. The surplus note was scheduled to mature on June 30, 2010, but was retired in May of 2005 at a total cost of \$4,148,672.88.

B. Subsidiary

The Company owns 100% of Production Partners LLC (“PPLLC”), an insurance marketing and sales company. PPLLC in turn owns 100% of Administrative Partners Inc. (“API”). API was formed to act as a third party administrator and to facilitate the Company’s expansion in the worksite market. API is currently active for the purpose of processing settlement option payments in connection with the Company’s Bond Continuation Life Insurance Program (see section 3D of this report). An organization chart reflecting the relationship between the Company and significant entities in its holding company system as of December 31, 2004 follows:



The Company had 3 service agreements in effect with affiliates during the examination period.

Type of Agreement	Effective Date	Provider(s) of Service(s)	Recipient(s) of Service(s)	Specific Service(s) Covered	Income/ (Expense)* For Each Year of the Examination
General Agency	3/21/2003	PPLLC	The Company	General agency agreement	2002 \$ 0 2003 \$(7,978) 2004 \$(53,631)
Administrative Services **	11/15/2001	the Company	PPLLC	Provide personnel and use of facilities to PPLLC so PPLLC can provide general agency services	2002 \$ 0 2003 \$37,105 2004 \$29,333
Administrative Services	2/20/2003	the Company/API	API/the Company	API is the TPA for life premium collection, purchase of US savings bonds, and claims administration for the Bond Continuation Life Insurance Program, the Company provides personnel to API so API can provide services listed above	2003 \$56,014 2004 \$37,298

* Amount of Income or (Expense) Incurred by the Company

** No written agreement between the entities

The only written agreement between the Company and PPLLC is a general agency agreement. Through the examination work performed and discussions with Company personnel, it became clear that the nature and extent of services shared between the two entities goes beyond a general agency agreement; the Company also provided facilities and personnel to PPLLC.

The Company provided supporting documentation related to the formation of PPLLC (Operating Agreement and Certificate of Merger) and a brief narrative describing the services that the Company provides to PPLLC. No service agreement was ever executed between the two

entities relating to the personnel services and use of facilities provided by the Company to PPLLC.

The examiner recommends that the Company enter into a written agreement with its subsidiary, PPLLC, that clearly identifies the provider and recipient of all shared services and/or facilities, the nature and extent of services or facilities to be provided thereunder, the basis for allocating the costs or expenses incurred for providing services and facilities, and the terms for settlement between the entities.

C. Management

The Company's by-laws provide that the board of directors shall be comprised of not less than nine and not more than 25 directors. The by-laws provide that within one year following the end of the calendar year in which the Company exceeds \$1.5 billion in admitted assets, the Company will increase the size of the board of directors to a minimum of 13 directors. Directors are divided into three classes, as nearly equal as may be, and one class is elected for a term of three years at each annual meeting of the policyholders held in December of each year. Meetings of the board are held quarterly.

The 12 board members and their principal business affiliation, as of December 31, 2004, were as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>	<u>Year First Elected</u>
Robert J. Bennett * Jamesville, NY	Retired Vice Chairman M&T Bank Corporation	1995
David P. Cordeau* Fayetteville, NY	President Greater Syracuse Chamber of Commerce	2004
Richard S. Corriero * Naples, FL	Retired Managing Partner KPMG Peat Marwick LLP	1996
Paul W. De Lima * Syracuse, NY	Chief Executive Officer Paul De Lima Coffee Company, Inc.	1999
Roger J. Halbert * Gilbertsville, NY	Administrator and Chief Executive Officer Chase Memorial Nursing Home	1999

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>	<u>Year First Elected</u>
Jerry L. Harris * Hilton Head, SC	Retired President and Chief Executive Officer CGH Health Services	1976
William R. Hess Fayetteville, NY	Chairman of the Board, President and Chief Executive Officer Farmers and Traders Life Insurance Company	1997
Darlene D. Kerr * Syracuse, NY	Senior Vice President and Chief Administrative Officer National Grid USA Service Co., Inc.	1997
John F. Luchsinger Fayetteville, NY	Vice President, General Counsel, and Secretary Farmers and Traders Life Insurance Company	1987
Mary P. Oliker * Manlius, NY	Project Administrative Officer SUNY Health Science Center	1986
Alfred W. Popkess * Marcellus, NY	Partner MacKenzie Hughes LLP	1999
F. Philip Prelli * Barkhamsted, CT	President Tangarone & Prelli LLC	1995

* Not affiliated with the Company or any other company in the holding company system

Mr. David P. Cordeau resigned from the board of directors effective August 4, 2005 and was not replaced.

The examiner's review of the minutes of the meetings of the board of directors and its committees indicated that meetings were well attended and that each director attended a majority of meetings.

The Company amended its by-laws in May 2003. Article VII of the Company's by-laws was amended to state:

“ . . . Article VII, Section 4 is amended to read The Board of Directors by resolution adopted by a majority of the entire Board may designate from its members the following Standing Committees:

Executive Committee
Finance/Audit committee

Article VII, Section 4 be amended to read ‘The Finance/Audit committee shall consist of not less than five, nor more that seven Directors, who are not officers or employees of the company’

Article VII, Section 5 be amended to include as the last sentence of Finance/Audit Committee's responsibilities the following ‘The Finance/Audit Committee shall have general supervision and control of audits, examinations, investigations, and inspections of the financial affairs and operations of the Company . . . ’ ”

The minutes of the finance/audit committee meetings between May 19, 2003 and March 2005 indicate that the President of the Company was a member of and attended the finance/audit committee meetings. This is contrary to the Company's amended by-laws.

The examiner recommends that the Company comply with its amended by-laws by electing only independent directors to serve on the finance/audit committee.

The following is a listing of the principal officers of the Company as of December 31, 2004:

<u>Name</u>	<u>Title</u>
William R. Hess	President, and Chief Executive Officer
Terence M. Mawhinney	Senior Vice President and Chief Actuary
Arnold N. Pechler III	Senior Vice President - Marketing
Donald G. Cook	Vice President and Treasurer
John F. Luchsinger*	Vice President, General Counsel and Secretary
Scott A. Claflin	Vice President – Actuary
Frank J. D’Onofrio, Jr.	Vice President – Investments
Barbara F. Stepien	Vice President - Administrative Services

* Designated consumer services officer per Section 216.4(c) of Department Regulation No. 64

In June 2005, James M. Smith replaced Arnold N. Pechler III as Senior Vice President of Marketing.

D. Territory and Plan of Operation

The Company is authorized to write life insurance, annuities and accident and health insurance as defined in paragraphs 1, 2 and 3 of Section 1113(a) of the New York Insurance Law.

The Company is licensed to transact business in 31 states and the District of Columbia. In 2004, 52.5% of life premiums and 84.8% of annuity considerations were received from New York. Policies have been written on a participating basis since January 1, 1955. Prior to January 1, 1955, policies were issued on a non-participating basis.

The Company sells whole life, term life, universal life, guaranteed and simplified issue senior life products with modified death benefits, and fixed interest annuities. The Company has refocused its marketing efforts to a “needs” based approach targeting middle-income families, rural and suburban markets. The Company’s senior products and annuities are not currently being emphasized.

Growth of the ordinary life business over the examination period is primarily attributable to the expansion of the Company’s Worksite marketing and the Bond Continuation Life Insurance Program. Worksite and Bond Continuation Life Insurance Program premiums are paid by salary deduction. The Company offers a portable, voluntary participating whole life insurance product through Worksite and the Bond Continuation Life Insurance Program on a simplified and guaranteed issue basis. Eligibility for guaranteed issue is contingent upon the number of eligible employees, requisite participation levels, and whether or not an approved enroller is used. The Bond Continuation Program is an employer sponsored program whereby an agent works with the employer’s benefit department to offer employees the option to purchase United States Savings Bonds. In addition, the employees may choose to purchase a life insurance policy through the program where the death benefit would be used to fund the continued purchase of savings bonds for a period of ten years in the event of the death of the insured employee. If at the end of the ten years, there is still remaining value from the life insurance policy, the residual value is paid to the named beneficiary.

The Company’s agency operations are conducted on a general agency basis.

E. Reinsurance

As of December 31, 2004, the Company had reinsurance treaties in effect with nine companies, all of which were authorized or accredited. The Company's ordinary life business is reinsured on a coinsurance and yearly renewable term basis while accident and health business is reinsured on a coinsurance basis. Reinsurance is provided on an automatic and facultative basis.

The maximum retention limit for individual life contracts is \$100,000. The total face amount of life insurance ceded as of December 31, 2004, was \$173,630,388, which represents 8.57% of the total face amount of life insurance in force.

4. SIGNIFICANT OPERATING RESULTS

Indicated below is significant information concerning the operations of the Company during the period under examination as extracted from its filed annual statements. Failure of items to add to the totals shown in any table in this report is due to rounding.

The following table indicates the Company's financial growth during the period under review:

	December 31, <u>2001</u>	December 31, <u>2004</u>	<u>Increase</u>
Admitted assets	<u>\$424,262,317</u>	<u>\$488,779,646</u>	<u>\$64,517,329</u>
Liabilities	<u>\$396,968,904</u>	<u>\$454,331,927</u>	<u>\$57,363,023</u>
Surplus notes	\$ 4,000,000	\$ 4,000,000	\$ 0
Unassigned funds (Surplus)	<u>23,293,413</u>	<u>30,447,719</u>	<u>7,154,306</u>
Total surplus	<u>\$ 27,293,413</u>	<u>\$ 34,447,719</u>	<u>\$ 7,154,306</u>
Total liabilities and surplus	<u>\$424,262,317</u>	<u>\$488,779,646</u>	<u>\$64,517,329</u>

The Company's invested assets as of December 31, 2004 were mainly comprised of bonds (92%) and contract loans (6%).

The majority (98.1%) of the Company's bond portfolio, as of December 31, 2004 was comprised of investment grade obligations.

Section 91.5(b) of Department Regulation No. 33 states, in part:

“A licensed life insurer proposing to adopt an investment year method in the distribution of net investment income, or to revise such a method already in effect, shall on or before November 1 of the first year for which such method or revision is to be used file with the superintendent a full description of its plan . . . ”

Prior to 2003, the Company used the mean reserve method to distribute net investment income to lines of business. In 2003, the Company allocated net investment income using a segmentation method that employs modified ratios for interest sensitive and non-interest sensitive lines of business. Use of the current method effectively allocates higher net investment income to participating lines of business that earn dividends. The Company did not file the plan with the Department prior to its use.

The Company violated Section 91.5(b) of Department Regulation No. 33 by failing to file a full description of its plan or method for distributing net investment income to lines of business with the Superintendent.

The following is the net gain (loss) from operations by line of business after federal income taxes but before realized capital gains (losses) reported for each of the years under examination in the Company's filed annual statements:

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Ordinary:			
Life insurance	\$1,140,567	\$ 933,302	\$ 907,172
Individual annuities	588,560	1,767,884	1,694,041
Supplementary contracts	<u>133,223</u>	<u>34,963</u>	<u>(51,174)</u>
Total ordinary	\$1,862,350	\$2,736,149	\$2,550,039
Group annuities	\$ 267,080	\$ 200,732	\$ 167,990
Accident and health – other	\$ <u>(105,041)</u>	\$ <u>(235,025)</u>	\$ <u>(58,432)</u>
Total	<u>\$2,024,389</u>	<u>\$2,701,856</u>	<u>\$2,659,597</u>

In 2001, the Company reported a net gain from operations of \$1,537,440 for its ordinary life line of business. In 2002, higher mortality and increased expenses on traditional products led to reduced profitability. In 2003, higher mortality, specifically in the guaranteed senior market, continued the decline in the profitability of the Company's traditional block. Although the Company was on target with its strategy of de-emphasizing the senior product and focusing on worksite production, death benefits were higher than expected in 2004. In addition, increased traditional life sales placed a strain on the profitability of traditional products in 2004.

With respect to the Company's individual annuity line of business, new annuity business peaked in 2002. In 2002, a decrease in surrender activity was offset by the strain of higher expenses resulting from increased annuity production. Starting in 2003, the Company attempted to control growth and manage new business by suspending the sale of new annuities mid-year and setting a goal that was more consistent with prior period production levels. The Company also lowered interest crediting rates and compensation. This strategy continued through the end of the examination period. While the Company reduced new annuity production, it offered other

carriers' annuity products through PPLLC. This activity was intended to enable the Company to earn an override from these other products, which helped offset some operating expenses and provide a modest profit.

The Company's accident and health business is a closed block of business in run off since 2001. The Company consistently experienced net losses because premium income generated by the remaining active policies is not enough to support the related administrative costs.

5. FINANCIAL STATEMENTS

The following statements show the assets, liabilities and surplus as of December 31, 2004, as contained in the Company's 2004 filed annual statement, a condensed summary of operations and a reconciliation of the surplus account for each of the years under review. The examiner's review of a sample of transactions did not reveal any differences which materially affected the Company's financial condition as presented in its financial statements contained in the December 31, 2004 filed annual statement.

A. ASSETS, LIABILITIES AND SURPLUS AS OF DECEMBER 31, 2004

Admitted Assets

Bonds	\$433,238,917
Stocks:	
Preferred stocks	248,863
Common stocks	59,802
Mortgage loans on real estate	
First liens	170,629
Real estate:	
Properties occupied by the company	458,452
Properties held for the production of income	704,993
Cash, cash equivalents and short term investments	11,977,741
Contract loans	25,852,657
Other invested assets	30,630
Investment income due and accrued	6,231,251
Premiums and considerations:	
Uncollected premiums and agents' balances in the course of collection	1,100,905
Deferred premiums, agents' balances and installments booked but deferred and not yet due	6,070,787
Reinsurance:	
Amounts recoverable from reinsurers	4,325
Funds held by or deposited with reinsured companies	363
Net deferred tax asset	1,854,500
Electronic data processing equipment and software	60,197
Receivables from parent, subsidiaries and affiliates	96,922
Reinsurance receivable	<u>617,712</u>
 Total admitted assets	 <u>\$488,779,646</u>

Liabilities and Surplus

Aggregate reserve for life policies and contracts	\$423,009,840
Aggregate reserve for accident and health contracts	448,203
Liability for deposit-type contracts	20,891,306
Contract claims:	
Life	1,699,777
Accident and health	9,005
Provision for policyholders' dividends and coupons payable in following calendar year – estimated amounts:	
Dividends apportioned for payment	3,780,000
Premiums and annuity considerations for life and accident and health contracts received in advance	287,968
Contract liabilities not included elsewhere	
Interest maintenance reserve	1,307,832
Commissions to agents due or accrued	201,319
General expenses due or accrued	598,386
Taxes, licenses and fees due or accrued, excluding federal income taxes	36,149
Current federal and foreign income taxes	(215,000)
Amounts withheld or retained by company as agent or trustee	647,959
Remittances and items not allocated	103,662
Liability for benefits for employees and agents if not included above	498,252
Asset valuation reserve	920,164
Reserve for excess interest on life insurance	8,600
Reserve for excess interest on supplementary contracts	20,100
Uncashed checks pending escheatment	<u>78,405</u>
 Total liabilities	 <u>\$454,331,927</u>
Surplus notes	\$ 4,000,000
Unassigned funds (surplus)	<u>30,447,719</u>
 Total surplus	 <u>\$ 34,447,719</u>
 Total liabilities and surplus	 <u>\$488,779,646</u>

B. CONDENSED SUMMARY OF OPERATIONS

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Premiums and considerations	\$57,449,764	\$51,336,471	\$42,528,366
Investment income	27,115,605	27,058,742	26,600,941
Commissions and reserve adjustments			
on reinsurance ceded	924	670	685
Miscellaneous income	<u>233</u>	<u>103,011</u>	<u>622,684</u>
Total income	<u>\$84,566,527</u>	<u>\$78,498,894</u>	<u>\$69,752,675</u>
Benefit payments	\$33,788,371	\$32,794,152	\$39,907,060
Increase in reserves	28,159,389	22,802,697	6,927,886
Commissions	4,558,311	4,189,500	3,608,913
General expenses and taxes	11,401,489	11,463,587	11,596,670
Increase in loading on deferred and uncollected premium	<u>76,204</u>	<u>88,460</u>	<u>500,709</u>
Total deductions	<u>\$77,983,764</u>	<u>\$71,338,397</u>	<u>\$62,541,238</u>
Net gain	\$ 6,582,762	\$ 7,160,497	\$ 7,211,438
Dividends	4,080,912	3,872,776	3,729,033
Federal and foreign income taxes incurred	<u>477,464</u>	<u>585,867</u>	<u>822,806</u>
Net gain from operations before net realized capital gains	\$ 2,024,386	\$ 2,701,855	\$ 2,659,599
Net realized capital (losses)	<u>(2,380,930)</u>	<u>(190,153)</u>	<u>(412,998)</u>
Net income (loss)	<u>\$ (356,544)</u>	<u>\$ 2,511,702</u>	<u>\$ 2,246,600</u>

The Company suffered from lower net investment income during the examination period as compared to prior periods due to the effect of lower interest rates, defaults and defensive shifting to higher quality securities that impacted operating results across all lines of business. This was lessened by reductions in dividend scales on traditional products and reduced interest rate credits on the Company's universal life and annuity products that continued throughout the examination period.

The Company's decision to de-emphasize or limit new annuity production in mid-2003 had a direct impact on total annuity considerations, the change in reserves, and commissions in

2003 and 2004. Increased annuity surrender activity also had an effect on the change in reserves and contributed to the increase in benefit payments in 2004.

Miscellaneous income increased in 2004 due to a non recurring event involving a legal settlement between the Company and the Leverage Group related to the Company's purchase of PolicyLink, the Company's policy administrative system. Approximately \$500,000 of the miscellaneous income came from the settlement with the Leverage Group.

The Company realized capital losses in 2002 due to impairments in its holdings of United Airlines, Consecro, Amerco, and Rochester Telephone.

C. SURPLUS ACCOUNT

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Surplus, December 31, prior year	\$ <u>27,293,413</u>	\$ <u>30,290,424</u>	\$ <u>32,723,451</u>
Net income	\$ (356,544)	\$ 2,511,702	\$ 2,246,600
Change in net unrealized capital gains (losses)	(502,735)	507,629	(36,803)
Change in net deferred income tax	196,000	64,500	65,500
Change in non-admitted assets and related items	(542,097)	175,858	(559,642)
Change in asset valuation reserve	1,659,387	(826,663)	8,613
Cumulative effect of changes in accounting principles	<u>2,543,000</u>	<u>0</u>	<u>0</u>
Net change in surplus for the year	\$ <u>2,997,011</u>	\$ <u>2,433,027</u>	\$ <u>1,724,269</u>
Surplus, December 31, current year	\$ <u>30,290,424</u>	\$ <u>32,723,451</u>	\$ <u>34,447,719</u>

6. MARKET CONDUCT ACTIVITIES

The examiner reviewed various elements of the Company's market conduct activities affecting policyholders, claimants, and beneficiaries to determine compliance with applicable statutes and regulations and the operating rules of the Company.

A. Advertising and Sales Activities

The examiner reviewed a sample of the Company's advertising files and the sales activities of the agency force including trade practices, solicitation and the replacement of insurance policies.

Section 219.4(m) of Department Regulation No. 34-A states:

“In the event an advertisement uses nonmedical, no medical examination required, or similar terms where issue is not guaranteed, such terms shall be accompanied, in each instance, by a disclosure of equal prominence and in juxtaposition thereto to the effect that issuance of the policy or payment of benefits may depend upon the answers given in the application and the truthfulness thereof.”

Five Company advertisements (Form No. 20-436, Form No. 20-444, Form No. 20-478, Form No. 20- 440 AJ 9/04, and Form No. 20-158 1/99) used to advertise the Company's simplified issue products (where issuance of the policy is not guaranteed) state that “No examination or blood work is required” but fail to disclose that issuance of the policy or payment of benefits may depend upon the answers given in the application and the truthfulness thereof.

The Company violated Section 219.4(m) of Department Regulation No. 34-A by using advertising forms for its simplified issue products where the Company advertised that no medical examination or blood work was required, but failed to disclose that issuance of the policy or payment of benefits may depend upon the answers given in the application and the truthfulness thereof.

Section 51.5 of Department Regulation No. 60 states, in part:

“Each agent and broker shall . . .

(c) Where a replacement has occurred or is likely to occur . . .

(3) Present to the applicant, not later than at the time the applicant signs the application, the ‘IMPORTANT Notice Regarding Replacement or Change of Life Insurance Policies or Annuity Contracts’ and a completed ‘Disclosure Statement’ signed by the agent or broker in the form prescribed by the Superintendent of Insurance and leave copies of such forms with the applicant for his or her records . . .

(5) Submit with the application to the insurer replacing the life insurance policy or annuity contract: a list of all life insurance policies or annuity contracts proposed to be replaced; a copy of any proposal, including the sales material used in the sale of the proposed life insurance policy or annuity contract; proof of receipt by the applicant of the ‘IMPORTANT Notice Regarding Replacement or Change of Life Insurance Policies or Annuity Contracts;’ and the completed ‘Disclosure Statement,’ including the primary reason(s) for recommending the new life insurance policy or annuity contract and why the existing life insurance policy or annuity contract cannot meet the applicant's objectives.”

Section 51.6(b) of Department Regulation No. 60 states, in part:

“Where a replacement has occurred or is likely to occur, the insurer replacing the life insurance policy or annuity contract shall . . .

(1) Require with or as part of each application a list prepared by the agent or broker representing, to the best of his or her knowledge, all of the existing life insurance policies and annuity contracts proposed to be replaced;

(2) Require with or as part of each application a copy of any proposal, including the sales material used in the sale of the proposed life insurance policy or annuity contract, and proof of receipt by the applicant of the ‘IMPORTANT Notice Regarding Replacement or Change of Life Insurance Policies or Annuity Contracts’ and the completed ‘Disclosure Statement;’

(3) Examine any proposal used, including the sales material used in the sale of the proposed life insurance policy or annuity contract, and the ‘Disclosure Statement,’ and ascertain that they are accurate and meet the requirements of the Insurance Law and this Part;

(4) Within ten days of receipt of the application furnish to the insurer whose coverage is being replaced a copy of any proposal, including the sales material used in the sale of the proposed life insurance policy or annuity contract, and the completed ‘Disclosure Statement’ . . .

(6) Where the required forms are received with the application and found to be in compliance with the Part, maintain copies of: any proposal, including the sales material used in the sale of the proposed life insurance policy or annuity contract; proof of receipt by the applicant of the ‘IMPORTANT Notice Regarding Replacement or Change of Life Insurance Policies or Annuity Contracts;’ the signed and completed ‘Disclosure Statement;’ and the notification of replacement to the insurer whose life insurance policy or annuity contract is to be replaced

indexed by agent and broker, for six calendar years or until after the filing of the report on examination in which the transaction was subject to review by the appropriate insurance official of its state of domicile, whichever is later;

(7) Where the required forms are not received with the application, or if the forms do not meet the requirements of this Part or are not accurate, within ten days from the date of receipt of the application either have any deficiencies corrected or reject the application and so notify the applicant of such rejection and the reason therefor. In such cases, the insurer shall maintain any material used in the proposed sale, in accordance with the guidelines of Section 51.6(b)(6) herein . . .

(9) In the event the life insurance policy or annuity contract issued differs from the life insurance policy or annuity contract applied for, ensure that the requirements of this Part are met with respect to the information relating to the life insurance policy or annuity contract as issued, including but not limited to the revised 'Disclosure Statement,' any revised or additional sales material used and acknowledgement by the applicant of receipt of such revised material."

The Company maintains a database of replacement activity. The Company provided an extract from that database to satisfy the examiner's request for replacement transactions subject to Department Regulation No. 60. The data file contained transactions where the applicant was liquidating non-insurance investment related vehicles (i.e. certificates of deposit, mutual funds, rollover of funds invested in deferred compensation plans) to purchase a Company policy or annuity contract. These transactions should not be included in the index of replacements required to be maintained by Department Regulation No. 60.

The examiner recommends that the Company maintain an accurate index of replacements by agent, as required by Section 51.6(b)(6) of Department Regulation No. 60.

In 31 out of 59 (53%) external replacement transactions reviewed and in nine out of 11 (82%) internal replacement transactions reviewed, the examiner was able to determine that a revised Disclosure Statement was required because the policy or contract was issued other than as applied for and that the Disclosure Statement contained inaccuracies for either the proposed policy or contract and/or the existing policy(ies) or contract(s). The Company stated that it did not require revised Disclosure Statements when the policy or contract was issued on a basis that differed from the policy or contract applied for and presented in the Disclosure Statement. The Company admitted that during the examination period, there was a breakdown in internal control procedures and the Company did not closely review the source documents, Disclosure Statements, applications, and the issued policies or annuity contracts to ensure the information was valid and consistent throughout the replacement transaction.

The Company violated Sections 51.6(b)(9) and 51.6(b)(3) of Department Regulation No. 60 by failing: to provide the applicant with a revised Disclosure Statement when the life insurance policy or annuity contract differed from the life insurance policy or annuity contract applied for; and examine proposals used, including the sales material used in the sale of the proposed life insurance policy or annuity contract, and the Disclosure Statement, and ascertain that they were accurate and met the requirements of the Regulation.

In eight out of 59 (13.56%) external replacement transactions reviewed and in one of 11 internal replacement transactions reviewed, the agent failed to obtain and present to the applicant on or before the date that the application was taken one or both of the following required documents: 1) "IMPORTANT Notice Regarding Replacement or Change of Life Insurance Policies or Annuity Contracts" ("Important Notice") and 2) a completed Disclosure Statement signed by the applicant and the agent. For three of the eight external replacements and the internal replacement, evidence maintained in the policy record indicates that the agent obtained these forms after the application and the paperwork had been submitted to and received by the Company. The Company did not reject the applications. In the remaining five external replacements, the agent obtained the replacement forms after the date of the application, but these forms were submitted to the home office with the application. There were an additional four external replacement transactions where the agent failed to submit one or more of the required replacement forms with the application. In these instances, the Company did not reject the applications even though they were not received by the home office within the prescribed timeframe.

The Company violated Section 51.6(b)(7) of Department Regulation No. 60 by failing to reject the application in situations where the required Important Notice and/or Disclosure Statement forms were not received with the application.

A copy of the agent authorization form (Request for Policy Disclosure Information, Form No. 20-318) and the notification of replacement to the insurer whose life insurance or annuity contract was to be replaced, was not maintained in the policy record for 7 out of 59 (12%) external replacement transactions reviewed. The Company's replacement procedures, provided in response to the First Day Letter, indicate that a copy of the agent authorization form (or notification letter) must accompany every application where a replacement is likely to occur.

However, the Company did not enforce their own written procedures and did not require their agents to submit this information with the application during the examination period.

The Company violated Section 51.6(b)(6) of Department Regulation No. 60 and its own procedures by failing to maintain copies of the notification of replacement to the insurer whose life insurance was being replaced. Such information is necessary in order to reconstruct the solicitation and underwriting of the contract or policy with regard to whether or not the agent satisfied the mandatory waiting period before completing the Disclosure Statement in cases where approximations are used.

In 12 out of 59 (20%) external replacement transactions reviewed, a copy of the information obtained from the existing insurer(s), necessary to complete the Disclosure Statement was not maintained in the policy record. Similarly, in four out of 11 (36%) internal replacement transactions reviewed, there was no documentation in the policy record to support the values used by the agent in the Disclosure Statement for the existing policy or contract. In addition, the Company was unable to provide support for the values used in the Disclosure Statement for the four internal replacements. As a result, the examiner was unable to determine the accuracy of the information for the existing policies contained in the Disclosure Statements.

Similarly, in 19 out of 59 (32%) external replacement transactions reviewed and in eight of 11 (73%) internal replacement transactions reviewed, the examiner was unable to locate the sales material or proposal that was used by the agent to complete the Disclosure Statement for the proposed policy or contract. In addition, the Company was unable to provide documentation to substantiate the values shown in the Disclosure Statement for the proposed life insurance policies or annuity contracts. As a result, the examiner was unable to determine the accuracy of the information for the proposed policies contained in the Disclosure Statements.

The Company's replacement procedures on file with the Department and those submitted to the examiner in response to the First Day Letter clearly indicate that the agent is required to submit the aforementioned information with the application. However, during the examination period the Company admitted that it did not enforce its written procedures by obtaining a copy of the source documents used by the agents to prepare the required Disclosure Statement for replacements of life insurance policies or annuity contracts during the examination period. Without a copy of the information provided by the existing insurer (external or internal), it is

impossible for the Company to determine the accuracy of the information reported on the Disclosure Statement for the existing policy(ies) or contract(s).

The Company violated Section 51.6(b)(3) of Department Regulation No. 60 by failing to examine and ascertain that Disclosure Statements completed by its agents and submitted with applications during the examination period were accurate since the Company did not: 1) obtain or maintain information from the replaced insurer to verify the information on the Disclosure Statements; and 2) require or maintain a copy of the proposal, including the sales material used, for the proposed life insurance policy or annuity contract from its agents.

In five out of 38 (13%) life external replacement transactions reviewed, the Company took more than ten days to furnish the existing insurer(s) with a copy of the sales material and Disclosure Statement used in the sale. In addition, the Company admitted that there was a breakdown in internal control procedures during the examination period and that the Company did not furnish the existing insurer(s) with a copy of the sales material or Disclosure Statement used in the sale when annuity replacement transactions were processed.

The Company violated Section 51.6(b)(4) of Department Regulation No. 60 by failing to furnish to the existing insurer a copy of the proposal(s) or sales material used in the sale of the proposed life insurance policy or annuity contract, and the completed Disclosure Statement within ten days of receipt of the application.

As a result of the aforementioned examination findings involving violations of Department Regulation No. 60, the Company performed a review of all external and internal replacement transactions made from January 1, 2002 through December 31, 2005. The review focused on compliance with Department Regulation No. 60 and the identification of policyholders that may have been adversely affected by the Company's lack of providing timely, complete and accurate disclosure during the sales process.

The Department and the Company have agreed on remediation plans for those policyholders that have been adversely affected.

B. Underwriting and Policy Forms

The examiner reviewed a sample of new underwriting files, both issued and declined, and the applicable policy forms.

Based upon the sample reviewed, no significant findings were noted.

C. Treatment of Policyholders

The examiner reviewed a sample of various types of claims, surrenders, changes and lapses. The examiner also reviewed the various controls involved, checked the accuracy of the computations and traced the accounting data to the books of account.

The Company's Savings Bond Continuation Program ("Program") is administered by the National Bond and Trust Company ("NBT"). NBT works with employer benefit departments to offer employees the option to purchase United States Savings Bonds. In addition, employees may choose to purchase life insurance through the program where the death benefit would be used to fund the continued purchase of savings bonds for a period of ten years in the event of the death of the insured employee. The funding vehicle used to continue the purchase of the US Savings Bonds in the event of the death of an employee/insured is a life insurance policy issued by the Company. The examiner reviewed the marketing material and policy form filings applicable to the Program. The Program uses the death benefit of a life insurance policy to purchase US Savings Bonds through an out of state trust. Based upon the marketing material, a prospective applicant must purchase a life insurance policy from the Company in order to participate in the bond continuation program. When the Company filed the applicable policy form (Form 9001) with the Department, the Company did not disclose that it planned to market the policy in the manner described.

The examiner recommends that the Company submit the policy forms used for the Program and disclose in the submission how the forms will be used in conjunction with the Program.

Section 53-3.5 of Department Regulation No. 74 states, in part:

"(a) If a basic illustration is used by an insurance producer or other authorized representative of the insurer in the sale of a life insurance policy and the policy is applied for as illustrated, a copy of that illustration, signed in accordance with

this Subpart, shall be submitted to the insurer at the time of policy application. A copy also shall be provided to the applicant . . . ”

(b) If no illustration is used by an insurance producer or other authorized representative of the insurer in the sale of a life insurance policy or if the policy is applied for other than as illustrated, the producer or representative shall certify to that effect in writing on a form provided by the insurer. On the same form the applicant shall acknowledge that no illustration conforming to the policy applied for was provided and shall further acknowledge an understanding that an illustration conforming to the policy as issued will be provided no later than at the time of policy delivery. This form shall be submitted to the insurer at the time of policy application. If the policy is issued, a basic illustration conforming to the policy as issued shall be sent with the policy and signed no later than the time the policy is delivered. A copy shall be provided to the insurer and the policyowner . . . ”

During the examination period, a certification of non-illustration form (Form No. 17-086 03/02) was authorized by the Company to be used in sales scenarios where there was no illustration used at the point of sale, the illustration that was used in the sale was different than the policy applied for; or the agent illustrated the policy on a personal computer (“PC”) screen at the point of sale, but did not print a copy of the illustration and leave it with the applicant for his or her records. In instances where the Company’s agents illustrate the policy on a PC screen, no preliminary information was provided to the applicant in writing. The Company used the electronic sales illustration in lieu of the preliminary information and policy summary documents required by Section 3209 of the New York Insurance Law. As a result, the Company did not obtain a signed receipt for a copy of the basic illustration at the time of application. It is noted that in such cases the Company issued a revised illustration for delivery with the policy.

The Company violated Section 53-3.5(a) of Department Regulation No. 74 by failing to provide and obtain a signed receipt for a copy of the basic illustration that was used during the sales process when an electronic illustration was used to satisfy preliminary information requirements for policies being marketed with an illustration.

Section 3209 of the New York Insurance Law states, in part:

(b) No policy of life insurance shall be delivered or issued for delivery in this state after the applicable effective date, as set forth in subsection (n) of this section, unless the prospective purchaser has been provided with the following:

(1) a copy of the most recent buyer’s guide and the preliminary information required by subsection (d) of this section, at or prior to the time an application is taken . . .

(d) The preliminary information shall be in writing and include, to the extent applicable, the following . . .

(5) the effective policy loan annual percentage interest rate, if the policy would contain this provision, and whether this rate is applied in advance or in arrears, adjustable or fixed . . .

(7) in addition, the applicant shall be advised that, when the policy is issued, a complete policy summary, including cost data, based on the benefits, premiums and dividends of the policy as issued, will be furnished; and that, following the receipt of the policy and policy summary, there will be a period of not less than ten days within which the applicant may return the policy for an unconditional refund of the premiums paid; and

(8) notwithstanding the foregoing, no applicant for life insurance shall be prevented or delayed in effecting or applying for coverage by the requirements of this section. In such cases where prior to application it is impractical to provide any items prescribed by this section, such items may be estimated in good faith or furnished as soon thereafter as practical prior to delivery of policy.

(e) A policy summary shall include the following . . .

(6) the effective policy loan annual percentage interest rate if the policy contains this provision . . .

(l) An insurer of any life insurance policy or annuity contract subject to this section shall notify the superintendent whether its policies or contract forms have been or will be marketed with or without an illustration . . . For those policies which are not marketed with an illustration, the preliminary information and policy summary shall be provided pursuant to the provisions of this section.”

In accordance with Section 3209(l) of the New York Insurance Law, the Company notified the Superintendent that policy forms 13-401 (Senior Protector III plan) and NCPP (New Century Permanent Protector plan) would not be marketed with an illustration. Senior Protector III plan is a guaranteed issue whole life plan designed for seniors. The New Century Permanent Protector plan is a simplified issue whole life plan. The examiner requested specimens of the preliminary information and policy summary documents authorized by the Company to be used during the examination period for these two policy forms.

With respect to the Senior Protector III plan, the Company provided a specimen preliminary information document that could be produced using the Company’s FIPSCO Illustration Software and was made available to agents during the examination period. However, this preliminary information document was not provided to applicants in some cases. The Company asserted that in some sales scenarios, it was impractical to provide the applicant with the preliminary information required by Section 3209(d) of the New York Insurance Law on or before the date that the application is taken. In such situations, disclosure information in the

form of the Statement of Policy Cost and Benefit Information (policy summary document) was provided, but not until delivery of the policy.

With regard to the New Century Permanent Protector plan, no preliminary information document was used. The Company provided the Statement of Policy Cost and Benefit Information (policy summary document) with delivery of the policy. Similar to the Company's Senior Protector III plan, the Company stated that it was impractical to provide the applicant with preliminary information at the point of sale.

The Company was unable to provide reasonable and sufficient explanation to the Department as to why it was impractical for its agents to provide such preliminary information required under Section 3209(d) of the New York Insurance Law to Senior Protector III and New Century Protector applicants during the examination period.

In addition, the examiner reviewed the format and content of the Statement of Policy Cost and Benefit Information (policy summary) documents authorized by the Company for policy forms 13-401 and NCPP for compliance with Section 3209(d) of the New York Insurance Law (i.e., preliminary information requirements). These documents failed to: 1) identify the effective policy loan annual percentage interest rate; and 2) disclose that when the policy is issued, a complete policy summary, including cost data, based on the benefits, premiums and dividends of the policy as issued, will be furnished and that, following the receipt of the policy and policy summary, there will be a period of not less than ten days within which the applicant may return the policy for an unconditional refund of the premiums paid. Similarly, the policy summary documents were not in compliance with Section 3209(e) of the New York Insurance Law (i.e., policy summary requirements) which also requires the Company to disclose the effective policy loan annual percentage interest rate, if the policy contains such a provision.

The Company violated Section 3209(b)(1) of the New York Insurance Law by failing to provide the required preliminary information in written form on or before the date that the application is taken.

The Company violated Sections 3209(d)(5) and 3209(e)(6) of the New York Insurance Law by failing to disclose the effective policy loan annual percentage interest rate of the policy in writing at or prior to the time that the application was taken and/or at the time of policy delivery.

The Company violated Section 3209(d)(7) of the New York Insurance Law by failing to disclose to applicants in writing that following the receipt of the policy and policy summary, there will be a period of not less than ten days within which the applicant may return the policy for an unconditional refund of the premiums paid.

Section 3203(a) of the New York Insurance Law states, in part:

“All life insurance policies, except as otherwise stated herein, delivered or issued for delivery in this state, shall contain in substance the following provisions, or provisions which the superintendent deems to be more favorable to policyholders

...

(16) that states on the policy data or policy specifications page of a life insurance policy subject to subsection (b) of section four thousand two hundred thirty-two of this chapter, to the extent applicable, that additional amounts are not guaranteed and the insurer has the right to change the amount of interest credited to the policy and the amount of cost of insurance or other expense charges deducted under the policy which may require more premium to be paid than was illustrated or the cash values may be less than those illustrated.”

The examiner reviewed the policy data and policy specifications page for a sample of policies issued during the examination period using policy form no. 8787, the Company’s universal life product. The policy data and policy specifications page for policy form no. 8787 fails to include a statement that additional amounts are not guaranteed and further, that the insurer has the right to change the amount of interest credited to the policy and the amount of cost of insurance or other expense charges deducted under the policy which may require more premium to be paid than what was illustrated or the cash values may be less than those illustrated.

The Company violated Section 3203(a)(16) of the New York Insurance Law by failing to include a statement on its policy data or specifications page for policy form no. 8787 that additional amounts are not guaranteed and further, that the insurer has the right to change the amount of interest credited to the policy and the amount of cost of insurance or other expense charges deducted under the policy which may require more premium to be paid than what was illustrated or the cash values may be less than those illustrated. The examiner also recommends that the Company develop and submit an endorsement for the Department’s approval that will be sent to the affected policyholders.

7. PRIVACY AND SAFEGUARDING

Section 420.13 of Department Regulation No. 169 states, in part:

“(a) General rule.

(1) The opt out requirements in sections 420.7 and 420.10 of this Part do not apply when a licensee provides nonpublic personal financial information to a nonaffiliated third party to perform services for the licensee or functions on the licensee's behalf, if the licensee . . .

(ii) Enters into a contractual agreement with the third party that prohibits the third party from disclosing or using the information other than to carry out the purposes for which the licensee disclosed the information, including use under an exception in section 420.14 or 420.15 of this Part in the ordinary course of business to carry out those purposes.”

Section 421.7 of Department Regulation No. 173 states:

“The licensee:

(a) Exercises appropriate due diligence in selecting its service providers; and

(b) Requires its service providers to implement appropriate measures designed to meet the objectives of this Part, and, where indicated by the licensee's risk assessment, takes appropriate steps to confirm that its service providers have satisfied such obligations.”

The examiners reviewed documentation provided by the Company related to the existence and effectiveness of internal controls and procedures in place to monitor compliance with Department Regulations No. 169 and No. 173 with respect to protecting and securing nonpublic personal consumer financial and health information.

During the examination period, several TPAs performed billing and collection administrative services on behalf of the Company in connection with the Bond Continuation Life Insurance Program. The Company does not have executed agreements that provide for the administrative services provided by these TPAs (National Bond and Trust, All American Benefits, and Payroll Deduction Services of America). In performing the billing and collection administrative services on behalf of the Company, these TPAs collect and maintain insureds' non-public personal financial and/or health information. The Company stated in writing that it has no formal privacy agreement with these TPAs.

The Company does have a formal, written administrative service agreement with Paylogix, LLC (“Paylogix”) that was executed on March 10, 2004. Section 9(B) of the

agreement contains limited language pertaining to privacy and safeguarding of nonpublic personal consumer financial and health information as follows:

“9. Maintenance of Records by the Administrator . . .

B. The aforementioned rights of government officials and Company to any such examination, inspection or audit shall be performed at the place where the records are kept. The Administrator will use reasonable efforts to keep all information contained in them, including, but not limited to, the identity and addresses of policyholders and holders of certificates, confidential”

The examiner recommends that the Company enter into written agreements with all TPAs that provide administrative services on its behalf and/or maintain nonpublic personal consumer financial and/or health information on its customers or policyholders that clearly identifies the information being disclosed and the purposes for such disclosure.

With respect to the Bond Continuation Life Insurance Program, two of the Company’s TPAs, National Benefit & Trust and All American Benefits, send confidential information such as the policyholder’s social security number along with premium information electronically through the Company’s system in a zip file format. This zip file is not encrypted or password protected. The Company’s external auditing firm, Price WaterhouseCoopers LLC, has not reviewed or tested the effectiveness of internal controls for operations performed by the third parties.

With respect to the Bond Continuation Life Insurance Program, the examiner recommends that the Company establish a secure mode of transmission to receive nonpublic personal consumer financial and health information from its TPAs through the use of passwords or some other encryption method to protect the confidential information of its policyholders.

In connection with the software licensing agreement between the Company and Falcon Technologies, Inc. (“Falcon”), whereby Falcon provides software and hardware for on-site payroll deduction enrollments, the Company stated that the following nonpublic personal consumer financial and health information is maintained on an off-site server:

- Employee: address, phone number, social security number, date of hire, hours worked, salary, employer and
- Employee, Spouse, Dependent Children: name, date of birth, occupation, height, weight, coverage applied for, application health question responses, and beneficiary.

The Company's Information Technologies Department has not conducted any tests to ensure or verify that the data electronically submitted to (uploaded) and/or downloaded from the Falcon server is adequately protected from unauthorized access to or use of nonpublic personal consumer financial and health information. In addition, Falcon did not make available to the examiner any audit reports verifying the existence and effectiveness of internal controls for safeguarding nonpublic personal consumer financial and health information residing on the Falcon server.

The examiner recommends that, if and when the Company amends the software licensing agreement between the Company and Falcon, the amended agreement contain provisions related to privacy and safeguarding that comply with the requirements of Department Regulations No. 169 and No. 173.

In addition, the examiner recommends that the Company establish adequate controls to monitor the activities of all TPAs providing services on its behalf that would include, but not necessarily be limited to, ensuring that nonpublic personal financial and health information of Company customers is being used only for the administration of the business, as agreed upon, and to verify that adequate protections to secure the information at the TPA's place of operation are in place.

Section 420.18 of Department Regulation No. 169 states, in part:

“(a) A valid authorization to disclose nonpublic personal health information pursuant to this Part shall be in written or electronic form and shall contain all of the following:

- (1) The identity of the consumer or customer who is the subject of the nonpublic personal health information;
- (2) A general description of the types of nonpublic personal health information to be disclosed;
- (3) General descriptions of the parties to whom the licensee discloses nonpublic personal health information, the purpose of the disclosure and how the information will be used;
- (4) The signature of the consumer or customer who is the subject of the nonpublic personal health information or the individual who is legally empowered to grant authority and the date signed; and
- (5) Notice of the length of time for which the authorization is valid and that the consumer or customer may revoke the authorization at any time and the procedure for making a revocation.

(b) An authorization shall specify a length of time, for which the authorization shall remain valid, which in no event shall be for more than 24 months.

(c) A consumer or customer who is the subject of nonpublic personal health information may revoke an authorization provided pursuant to this Part at any time, subject to the rights of an individual who acted in reliance on the authorization prior to notice of the revocation.

(d) A licensee that is subject to examination by this Department shall retain the authorization or a copy thereof in the record of the individual who is the subject of nonpublic personal health information for a period of six years from the date the authorization ends or until the examination is completed, whichever is greater. A licensee that is not subject to examination by this Department shall retain the authorization or a copy thereof in the record of the individual who is the subject of nonpublic personal health information for a period of six years from the date the authorization ends.”

The Company has included privacy disclosures on some of its application forms. The disclosures are somewhat confusing because authorizations to both obtain and disclose information have been combined onto one section of the application. The Company advised that it does not share nonpublic personal financial or health information except as authorized under Sections 420.14, 420.15 and 420.17 of Department Regulation No. 169, yet it was noted that the Company’s policy application forms (Form No. 17-100, No. 17-091-00 NY and No. 17-301 NY) did contain an authorization for the disclosure of nonpublic personal health information which failed to contain a notice that the consumer or customer may revoke the authorization at any time and the procedure for making a revocation. In addition, the authorizations contained in policy forms No. 17-091-00-NY and No. 17-301 NY stated that the authorization was valid for 30 months from the date it was signed by the proposed insured instead of 24 months.

In order to make the authorizations to obtain and disclose information clearer, the examiner recommends that the Company remove the authorizations to disclose nonpublic personal financial and/or health information from all its application forms and use separate notices to satisfy the requirements of Department Regulation No. 169.

8. INTERNAL AUDIT

In response to the examination planning questionnaire, the Company indicated that it does not have an internal audit department or function. In addition, the Company's responses to a number of pre-exam and first day letter request items failed to provide evidence that any self-audits or similar reviews were conducted on internal control procedures and/or systems in place to determine whether control procedures continued to be relevant and were able to address new risks of the respective business units (operations) during the examination period.

Internal audit is an integral part of corporate governance that includes the finance/audit committee, the board of directors, senior management and the external auditors. In particular, internal auditors and the finance/audit committee are mutually supportive. Consideration of the work of internal auditors is essential for the finance/audit committee to gain a complete understanding of the Company's operations. Internal audit identifies strategic, operational and financial risks facing the organization and assesses controls put in place by management to mitigate those risks.

The examiner recommends that the Company establish and maintain an independent, adequately resourced, and competently staffed internal audit function to provide management and the independent directors committee (the finance/audit committee) with ongoing assessments of the Company's risk management processes and the accompanying system of internal control.

9. INVESTMENT POLICIES AND PROCEDURES

The examiners reviewed the Company's Investment Policy (or Purchase Guidelines), the board and the finance/audit committee minutes and other documentation related to corporate governance over the Company's investment practices.

The Company does not have a formal board approved policy (or guidelines) with regard to the process and procedures currently in place for the monitoring and determination of impaired securities. The examiner's review of the board of directors and the finance/audit committee minutes did not reveal any evidence that a summary of investment write-downs showing the new cost basis for impaired securities was presented to the board for review and approval.

The examiner recommends that the Company establish a written, board-approved investment policy that includes guidelines regarding when a security may be considered impaired.

The Company's investment policy does not specify or provide a duration limit within which the portfolio duration (or the asset/liability net duration) should be maintained. Net duration should be reported to the finance/audit committee. It does not appear that the portfolio duration is reported to the board at the finance/audit committee meetings.

The examiner recommends that the Company establish a duration limit and that it be incorporated into the limit structure of the Company's investment policy. The examiner also recommends that the portfolio duration be reported to the board at the finance/audit committee meetings.

The Company's investment policy contains a number of terms and/or limitations that are not clearly defined. Terms such as "Benchmark Funds" and "Core Collateral" in category 1 of its investment policy, "DIR: 1", "DIR: 2", "PAR: 1" and "PAR: 2" in categories 4 and 7B of its investment policy could lead to speculation or doubt by either internal or external parties as to management's intent with respect to the approved policy.

The examiner recommends that the Company revise its investment policy to more clearly define the limits and terminology used in setting those limits so that the intent of management is clear to both the investment officer and external parties that may be called upon to ascertain whether or not the investment officer is managing the portfolio within the established limits and

guidelines. The revisions should be presented to the finance/audit committee at the next regular meeting for approval.

The Company's investment guidelines do not contain explicit limitations for investments in the NAIC classes, specifically below investment grade classes.

The examiner recommends that the Company develop and incorporate explicit limits with regard to the NAIC investment classes into its investment policy and that these limits be presented to the board at the next finance/audit committee meeting for approval.

10. REMITTANCES AND ITEMS NOT ALLOCATED

The Company reported a liability for “Remittances and Items Not Allocated” of \$103,662 as of December 31, 2004. The majority of the liability was comprised of two suspense accounts: 1) computer cash control; and 2) pending maturities.

A comparison of the computer cash control suspense detail inventory at December 31, 2004 to the suspense detail inventory at July 30, 2005 revealed that a number of suspense transactions had not been investigated, cleared or reconciled.

The examiner recommends that the Company review the accounts that comprise the liability “Remittances and Items Not Allocated,” and investigate, reconcile, and clear (resolve) suspense items in a more timely manner.

11. RECORD RETENTION PLAN

Section 243.3 of Department Regulation No. 152 states, in part:

“(a) (1) Records and indices of records required to be maintained under this Part may be maintained in any durable medium . . .

(c) An insurer shall establish and maintain a records retention plan. The plan shall include a description of the types of records being retained, the method of retention, and safeguards established to prevent alteration of the records. Such plan shall be provided to the superintendent upon request. The insurer shall certify the accuracy of any records that are provided in accordance with its record retention plan. . . .”

A review of the Company’s record retention plan revealed that it failed to include an index containing a description of the types of records being retained, the method of retention (i.e. media – microfiche, imaging software, hard copy, etc.), and the safeguards established to prevent alteration of the records.

The examiner recommends that the Company revise its record retention plan to include an index containing the types of records being retained, the method of retention, and the safeguards established to prevent alteration of the records.

12. DISASTER RECOVERY & BUSINESS CONTINUITY PLANS

The objective of a disaster recovery plan is to provide reasonable assurance that data, systems and operations can be successfully recovered and be available to users in the event of a disaster. The objective of a business continuity plan is to reasonably ensure that the recovery of critical business processes could take place in the event of a disaster.

The Company does not have separate business continuity plan and disaster recovery plan documents. Currently, planning efforts in these two areas have been incorporated into a Lotus Notes Database. While the Company's Lotus Notes Database is indicative of the progress that the Company has made in regard to disaster recovery planning and business continuity planning since February 2002, and also provides a solid foundation for the development of a comprehensive written plan, the Lotus Notes Database itself does not constitute a formal, written plan document. Ready access to the information contained in the Lotus Notes Database may be an issue in the event of a true disaster.

In addition, the Company is still in the process of developing PolicyLink end user manuals for each department or business unit. PolicyLink is the Company's policy administrative system. These manuals should be integrated into the Company's business continuity planning. Currently, the business continuity plan has not yet been tested (on or off-site). There is no evidence to suggest that disaster recovery testing has been performed off-site at the Company's hot-site or warm-site location (simulating real disaster conditions). The first disaster recovery test was performed in December 2003 and was limited to restoring PolicyLink from the most recent full back up tape within an eight hour period. The most recent test was performed on October 6, 2004 with an objective of restoring PolicyLink and Freedom (the Company's accounting system) as well as cycle related server data.

The examiner recommends that the Company continue its disaster recovery planning efforts by developing a formal, written plan that is tested on a regular basis. Such a plan should address hardware and system recovery, data retrieval procedures, emergency contact information, hardware/software vendor information, telecommunications recovery procedures, disaster declaration approval procedures, and physical recovery location. The plan should contain provisions to ensure periodical testing. The disaster recovery plan should be aligned with the business continuity plan, approved, and periodically reviewed by management to ensure

that it meets the needs of the business. Documentation of the disaster recovery test plan and results (indicating problems found or successful completions) and documentation of management approval of the plan should be maintained.

The examiner also recommends that the Company continue its business continuity planning efforts by developing a formal, written business continuity plan that is tested on a regular basis. Such a plan should identify the recovery of critical business processes. The plan should also identify supporting systems applications, vendors that would assist with locating alternate processing and office site locations, forms and documentation arrangements, network and application restoration procedures, and procedures to be followed by Company personnel during the disaster and recovery period. The plan should contain provisions to ensure periodical testing. The business continuity plan should be approved and periodically reviewed by management to ensure that it meets the needs of the business. Documentation of the business continuity test plan and results and documentation of management approval of the plan should be maintained.

13. PRIOR REPORT SUMMARY AND CONCLUSIONS

Following are the violation and recommendation contained in the prior report on examination and the subsequent actions taken by the Company in response to each citation.

<u>Item</u>	<u>Description</u>
A	<p>Advertisements that were used by the Company can be deemed misleading by emphasizing the investment and tax features rather than the insurance features of its products. The examiner recommended that the advertisements be rewritten to emphasize the life insurance features of the Company's products.</p> <p>The Company no longer uses these advertisements.</p>
B	<p>The Company violated Section 219.4(k) of Department Regulation No. 34-A by failing to mention that if the insured dies from sickness during the first two years of the policy that the premiums would be returned in lieu of the face amount.</p> <p>The Company no longer uses these advertisements.</p>

14. SUMMARY AND CONCLUSIONS

Following are the violations, recommendations and comment contained in this report:

<u>Item</u>	<u>Description</u>	<u>Page No(s).</u>
A	The examiner recommends that the Company enter into a written agreement with its subsidiary, PPLLC, that clearly identifies the provider and recipient of all shared services and/or facilities, the nature and extent of services or facilities to be provided thereunder, the basis for allocating the costs or expenses incurred for providing services and facilities, and the terms for settlement between the entities.	6 – 7
B	The examiner recommends that the Company comply with its amended by-laws by electing only independent directors to serve on the finance/audit committee.	9
C	The Company violated Section 91.5(b) of Department Regulation No. 33 by failing to file a full description of its plan or method for distributing net investment income to lines of business with the Superintendent.	12 – 13
D	The Company violated Section 219.4(m) of Department Regulation No. 34-A by using advertising forms for its simplified issue products where the Company advertised that no medical examination or blood work was required, but failed to disclose that issuance of the policy or payment of benefits may depend upon the answers given in the application and the truthfulness thereof.	20
E	The examiner recommends that the Company maintain an accurate index of replacements by agent, as required by Section 51.6(b)(6) of Department Regulation No. 60.	22
F	The Company violated Sections 51.6(b)(9) and 51.6(b)(3) of Department Regulation No. 60 by failing: to provide the applicant with a revised Disclosure Statement when the life insurance policy or annuity contract differed from the life insurance policy or annuity contract applied for; and examine proposals used, including the sales material used in the sale of the proposed life insurance policy or annuity contract, and the Disclosure Statement, and ascertain that they were accurate and met the requirements of the Regulation.	23

<u>Item</u>	<u>Description</u>	<u>Page No(s).</u>
G	The Company violated Section 51.6(b)(7) of Department Regulation No. 60 by failing to reject the application in situations where the required Important Notice and/or Disclosure Statement forms were not received with the application.	23
H	The Company violated Section 51.6(b)(6) of Department Regulation No. 60 and its own procedures by failing to maintain copies of the notification of replacement to the insurer whose life insurance is being replaced. Such information is necessary in order to reconstruct the solicitation and underwriting of the contract or policy with regard to whether or not the agent satisfied the mandatory waiting period before completing the Disclosure Statement in cases where approximations are used.	24
I	The Company violated Section 51.6(b)(3) of Department Regulation No. 60 by failing to examine and ascertain that Disclosure Statements completed by its agents and submitted with applications during the examination period were accurate since the Company did not: 1) obtain or maintain information from the replaced insurer to verify the information on the Disclosure Statements and 2) require or maintain a copy of the proposal, including the sales material used, for the proposed life insurance policy or annuity contract from its agents.	25
J	The Company violated Section 51.6(b)(4) of Department Regulation No. 60 by failing to furnish to the existing insurer a copy of the proposal(s) or sales material used in the sale of the proposed life insurance policy or annuity contract, and the completed Disclosure Statement within ten days of receipt of the application.	25
K	The Department and the Company have agreed on remediation plans for those policyholders that have been adversely affected.	25
L	The examiner recommends that the Company submit the policy forms used for the Program and disclose in the submission how the forms will be used in conjunction with the Program.	26
M	The Company violated Section 53-3.5(a) of Department Regulation No. 74 by failing to provide and obtain a signed receipt for a copy of the basic illustration that was used during the sales process when an electronic illustration was used to satisfy preliminary information requirements for policies being marketed with an illustration.	27

<u>Item</u>	<u>Description</u>	<u>Page No(s).</u>
N	The Company violated Section 3209(b)(1) of the New York Insurance Law by failing to provide the required preliminary information in written form on or before the date that the application is taken.	29
O	The Company violated Sections 3209(d)(5) and 3209(e)(6) of the New York Insurance Law by failing to disclose the effective policy loan annual percentage interest rate of the policy in writing at or prior to the time that the application was taken and/or at the time of policy delivery.	29
P	The Company violated Section 3209(d)(7) of the New York Insurance Law by failing to disclose to applicants in writing that following the receipt of the policy and policy summary, there will be a period of not less than ten days within which the applicant may return the policy for an unconditional refund of the premiums paid.	30
Q	The Company violated Section 3203(a)(16) of the New York Insurance Law by failing to include a statement on its policy data or specifications page for policy form no. 8787 that additional amounts are not guaranteed and further, that the insurer has the right to change the amount of interest credited to the policy and the amount of cost of insurance or other expense charges deducted under the policy which may require more premium to be paid than what was illustrated or the cash values may be less than those illustrated.	30
R	The examiner recommends that the Company develop and submit an endorsement for the Department's approval that will be sent to the affected policyholders.	30
S	The examiner recommends that the Company enter into written agreements with all TPAs that provide administrative services on its behalf and/or maintain nonpublic personal consumer financial and/or health information on its customers or policyholders that clearly identifies the information being disclosed and the purposes for such disclosure.	32
T	The examiner recommends that the Company establish for its Bond Continuation Life Insurance Program a secure mode of transmission to receive nonpublic personal consumer financial and health information from its TPAs through the use of passwords or some other encryption method to protect the confidential information of its policyholders.	32

<u>Item</u>	<u>Description</u>	<u>Page No(s).</u>
U	The examiner recommends that, if and when the Company amends the software licensing agreement between the Company and Falcon, the amended agreement contain provisions related to privacy and safeguarding that comply with the requirements of Department Regulation No. 169 and No. 173.	33
V	The examiner recommends that the Company establish adequate controls to monitor the activities of all TPAs providing services on its behalf that would include, but not necessarily be limited to, ensuring that nonpublic personal financial and health information of Company customers is being used only for the administration of the business, as agreed upon, and to verify that adequate protections to secure the information at the TPA's place of operation are in place.	33
W	The examiner recommends that the Company remove the authorizations to disclose nonpublic personal financial and/or health information from all its application forms and use separate notices to satisfy the requirements of Department Regulation No. 169.	34
X	The examiner recommends that the Company establish and maintain an independent, adequately resourced, and competently staffed internal audit function to provide management and the independent directors committee (finance/audit committee) with ongoing assessments of the Company's risk management processes and the accompanying system of internal control.	35
Y	The examiner recommends that the Company establish a written, board approved investment policy that includes guidelines regarding when a security may be considered impaired.	36
Z	The examiner recommends that the Company establish a duration limit and that it be incorporated into the limit structure of the Company's investment policy. The examiner also recommends that the portfolio duration be reported to the board at the finance/audit committee meetings.	36

<u>Item</u>	<u>Description</u>	<u>Page No(s).</u>
AB	The examiner recommends that the Company revise its investment policy to more clearly define the limits and terminology used in setting those limits so that the intent of management is clear to both the investment officer and external parties that may be called upon to ascertain whether or not the investment officer is operating the portfolio within the established limits and guidelines. The revisions should be presented to the finance/audit committee at the next regular meeting for approval.	36
AC	The examiner recommends that the Company develop and incorporate explicit limits with regard to the NAIC investment classes into its investment policy and that these limits be presented to the board at the next finance/audit committee meeting for approval.	37
AD	The examiner recommends that the Company review the accounts that comprise the liability “Remittances and Items Not Allocated” and investigate, reconcile, and clear items in a more timely manner.	38
AE	The examiner recommends that the Company revise its record retention plan to include an index containing the types of records being retained, the method of retention, and the safeguards established to prevent alteration of the records.	39
AF	The examiner recommends that the Company continue its disaster recovery planning efforts by developing a formal, written plan that is tested on a regular basis.	40
AG	The examiner recommends that the Company continue its business continuity planning efforts by developing a formal, written business continuity plan that is tested on a regular basis.	41

APPOINTMENT NO. 22338

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, HOWARD MILLS, Acting Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:

FLORA EGBUCHULAM

as a proper person to examine into the affairs of the

FARMERS AND TRADERS LIFE INSURANCE COMPANY

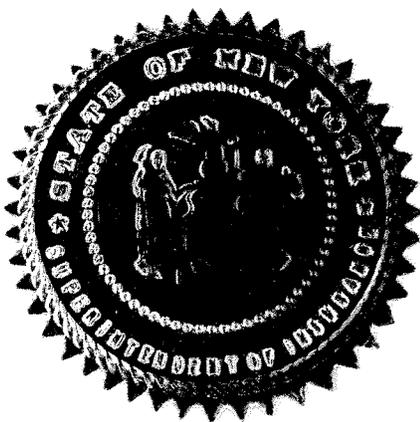
and to make a report to me in writing of the condition of the said

COMPANY

with such other information as she shall deem requisite.

*In Witness Whereof, I have hereunto subscribed by name
and affixed the official Seal of the Department
at the City of New York*

this 7th day of March, 2005



HOWARD MILLS

Acting Superintendent of Insurance

A handwritten signature in cursive script, appearing to read "Howard Mills", written over a horizontal line.

Acting Superintendent