STATE OF NEW YORK INSURANCE DEPARTMENT

REPORT ON EXAMINATION

OF THE

NATIONAL INTEGRITY LIFE INSURANCE COMPANY

CONDITION: DECEMBER 31, 2004

DATE OF REPORT: JULY 1, 2005

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EXAMINER:	STANLEY CHAN

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

George E. Pataki
Governor

Howard Mills
Superintendent

July 1, 2005

Honorable Howard Mills
Superintendent of Insurance
Albany, New York 12257

Sir:

In accordance with instructions contained in Appointment No. 22341, dated March 7, 2005**,** and annexed hereto, an examination has been made into the condition and affairs of National Integrity Life Insurance Company, hereinafter referred to as "the Company," at its home office located at 15 Matthews Street, Suite 200, Goshen, New York 10924.

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 that 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 Section 325(a) of the New York Insurance Law by failing to keep and maintain its books of account at its principal office in this state. A similar violation appeared in the prior Report on Examination. (See item 7 of this report)

The Company violated Section 1505(b) of the New York Insurance Law by failing to maintain records with sufficient detail to support the reasonableness of the charges or fees paid under its inter-company service agreements with Touchstone Securities, Inc. (Touchstone). (See item 3 of this report)

The Company violated Department Regulation No. 33 by: failing to provide documentation that supports the actual basis of the allocation of expenses between companies; using a general index to allocate general expenses among major annual statement lines of business; and failing to treat the allocation of general expenses between companies in the same manner as if made for major annual statement lines of business. (See item 3 of this report)

The examiner's review of the Company's market conduct activities did not reveal significant instances which deviated from the New York Insurance Law, Department Regulations and Circular Letters and the operating rules of the Company. (See item 6 of this report)

The examiner recommends that the Company's board of directors adopt a formal written investment policy statement that specifically addresses the portfolio's investment objectives, constraints and strategies. (See item 8 of this report)

The examiner recommends that the Company incorporate as part of its Business Continuity - Disaster Recovery Plan periodical testing of the Plan and that the Company maintain test results indicating problems found or successful completion. (See item 9 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 violations, recommendations and comments contained in the prior report on examination. The results of the examiner’s review are contained in item 10 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 November 22, 1968, was licensed and commenced business on December 30, 1968. Initial resources of $3,000,000, consisting of common capital stock of $1,000,000 and paid in and contributed surplus of $2,000,000, were provided through the sale of 100,000 shares of common stock (with a par value of $10 each) for $30 per share.

Capital was increased to $1,100,000 in 1972 as a result of the issuance of 10,000 additional shares of stock. Monumental Life Insurance Company acquired the Company from Merchants Mutual Insurance Company in July 1981 and the name was changed to Monumental Life Insurance Company of New York. The Equitable Life Assurance Society of the United States (“Equitable”) purchased the Company in November 1985. In 1985, capital was increased to $2,000,000 as the result of the issuance of 90,000 additional shares of stock. The Company adopted its present name on January 21, 1986. In September 1988, Equitable sold the Company to National Mutual Life Association of Australasia. In November 1993, ARM Financial Group acquired the Company and its immediate parent, Integrity. The Western and Southern Life Insurance Company (“WSLIC”) acquired Integrity and the Company in March 2000.

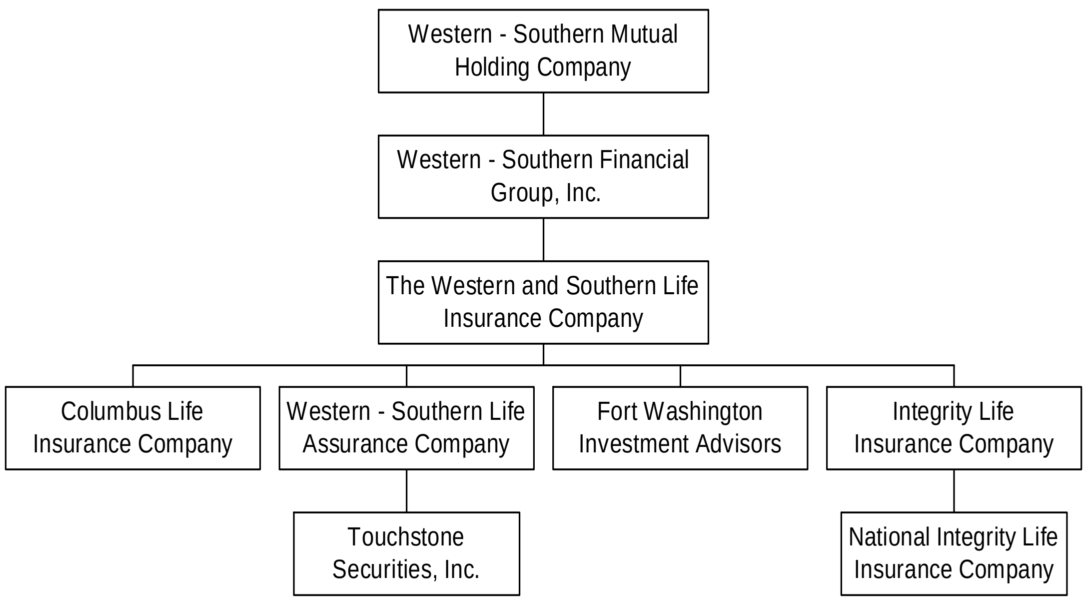
Changes in the Company’s capital and surplus prior to the examination period resulted in capital and paid in and contributed surplus of $2,000,000 and $101,069,159, respectively, as of December 31, 2001.

During 2002, 2003 and 2004, the Company received capital contributions of $55,301,690, $25,000,000 and $25,000,000, respectively, from Integrity. This increased the Company’s gross paid in and contributed surplus to $206,370,849. Capital and paid in and contributed surplus were $2,000,000 and $206,370,849, respectively, as of December 31, 2004.

B. Holding Company

The Company is a wholly owned subsidiary of Integrity, an Ohio life insurance company. As of December 31, 2001, Integrity was owned by WSLIC, an Ohio insurer, which in turn is a wholly owned subsidiary of Western – Southern Financial Group, Inc. ("WSFG"). The ultimate parent of the Company is Western – Southern Mutual Holding Company, ("WSMHC"), an Ohio holding company.

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 six service agreements in effect with affiliates during the examination period.

Type of Agreement and Department File Number	Effective Date	Provider(s) of Service(s)	Recipient(s) of Service(s)	Specific Service(s) Covered	Income/ (Expense)* For Each Year of the Examination
Investment Advisory Agreement (29281)	February 10, 2001	Fort Washington Investment Advisors, Inc. (Fort Washington)	The Company	Investment Advisory Services	2002 ($483,791) 2003 ($743,501) 2004 ($843,524)
Administrative Services Cost Sharing Agreement (29516)	May 7, 2002	Integrity	The Company	Administrative Services	2002 ($9,922,149) 2003 ($11,353,774) 2004 ($10,842,594)
Administrative Services Cost Sharing Agreement (29515)	May 7, 2002	WSLIC	The Company	Administrative Services	2002 ($23,396) 2003 ($39,426) 2004 ($27,231)
Broker-Dealer Sales Agreement (29517)	March 17, 2002	Touchstone	The Company	Solicit sales of the Company's products	2002 ($0) 2003 ($0) 2004 ($0)
Expense Reimbursement and Administrative Services Agreement (29517)	March 28, 2002	Touchstone	The Company	Supervisory and administrative services with respect to the Registered Employees	2002 ($0) 2003 ($0) 2004 ($0)
Expense Reimbursement and Administrative Services Agreement (29517)	March 28, 2002	The Company	Touchstone	Administrative and accounting services related to the distribution of the Company's variable annuity products	2002 $0 2003 $2,722,525 2004 $2,312,330

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

The Company also maintains a federal income tax allocation agreement with its parent and affiliates.

There were no payments made or received by the Company under either the Broker-Dealer Sales Agreement or the Administrative Services/Expense Reimbursement Agreement with Touchstone during the examination period. The Company explained that there were no payments made to Touchstone under the Broker-Dealer Sales Agreement due to a lack of sales.

In addition, the Company indicated that both Integrity and the Company have identical Expense Reimbursement and Administrative Services Agreements with Touchstone for the services provided by Touchstone. However, Touchstone did not separate out the charges for the two companies but billed the entire amount to Integrity during 2002, 2003 and 2004. Integrity allocated the Company's share of these charges to the Company via the Administrative Services Cost Sharing Agreement between Integrity and the Company.

The Expense Reimbursement and Administrative Services Agreement between Touchstone and the Company states that Touchstone shall submit to the Company a written statement of the fees for services pursuant to this agreement on a monthly basis and that the fees shall be payable within thirty days of receipt of such statement. Since the Company is not receiving any monthly billings or making any settlement in regard to this agreement, the Company is not in compliance with the terms of the agreement as filed with the Department.

The examiner recommends that the Company comply with terms of the Expense Reimbursement and Administrative Services Agreement with Touchstone as filed and approved by the Department.

Section 1505 of the New York Insurance Law states, in part:

> "(a) Transactions within a holding company system to which a controlled insurer is a party shall be subject to the following:
>
> (1) the terms shall be fair and equitable;
>
> (2) charges or fees for services performed shall be reasonable; and
>
> (3) expenses incurred and payments received shall be allocated to the insurer on an equitable basis in conformity with customary insurance accounting practices consistently applied.
>
> (b) The books, accounts and records or each party to all such transactions shall be so maintained as to clearly and accurately disclose the nature and details of the transactions including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties . . ."

A review of the records maintained by the Company supporting the charges or fees under all of its inter-company service agreements with Touchstone failed to include sufficient detail to clearly and accurately disclose the nature and details of the transactions as was necessary to support the reasonableness of the charges or fees paid to the respective parties. It should be noted that some of the inter-company charges with Touchstone were indirectly included in the Expense Reimbursement and Administrative Services Agreements between Touchstone and the Company's parent, Integrity. As a result, charges to the Company were paid by Integrity, on behalf of the Company.

It is unclear to the examiner what services are being provided by the Company for Touchstone and what services Touchstone is providing on behalf of the Company under any of its filed and approved service agreements.

The Company violated Section 1505(b) of the New York Insurance Law by failing to maintain records with sufficient detail to support the reasonableness of the charges or fees paid under its inter-company service agreements with Touchstone, including the charges or fees that were charged indirectly to Integrity on behalf of the Company.

Section 91.4 of Department Regulation No. 33 states, in part:

> "(a) . . . (2) Each life insurer shall maintain records with sufficient detail to show fully:
>
> (i) the system actually used for allocation of income and expenses;
>
> (ii) the actual bases of allocation;
>
> (iii) the actual monetary distribution of the respective items of income, salaries, wages, expenses, and taxes to:
>
> (a) units of activity or functions, if any distribution is made on such basis …
>
> (d) companies . . .
>
> (3) Such records shall be classified and indexed in such form as to permit ready identification between the item allocated and the basis upon which it was allocated, and shall be maintained in such a manner as to be readily accessible for examination. These records shall bear a date and shall identify the person responsible for the preparation thereof . . ."

A review of the method employed by the Company to allocate expenses under its Administrative Services Cost Sharing Agreement with Integrity indicated that time spent by various personnel on the business of either the Company or Integrity was supposed to be the basis for the allocation method used. However, in lieu of time studies, the Company indicated management discussions were held with supervisors and/or department heads concerning the amount of time personnel in their respective areas allocated between the two companies. The

Company was not able to provide any documentation to support the basis for the expense allocation between Integrity and the Company.

A review of the monthly billing statements provided in support of the charges incurred under the Administrative Services Cost Sharing Agreement between the Company and WSLIC included salaries that were fully allocated to the Company and salaries that were partially allocated to the Company. The monthly billing records failed to include any supporting documentation for the salaries partially allocated other than a voucher or a statement indicating only the amount charged without an explanation or documentation as to how WSLIC calculated the charge.

The Company violated Section 91.4(a)(2) of Department Regulation No. 33 by failing to provide documentation that supports the actual basis of the allocation of expenses between companies.

Section 91.4(a)(5) of Department Regulation No. 33 states:

> "Allocations of income and expenses between companies shall be treated in the same manner as if made for major annual statement lines of business."

Section 91.4(f)(5) of Department Regulation No. 33 states:

> "General indexes such as premium volume, number of policies, and insurance in force shall not be used as basis for distributing costs among major annual statement lines of business, except where the incidence of cost is closely related to such general indexes, or except where there is no more appropriate basis for measurement. Such general indexes may not be used in distributing claim costs to secondary annual statement lines of business."

The prior report on examination cited the Company for violating Section 91.4(f)(5) of Department Regulation No. 33 when it used a general index to allocate expenses between companies and among major annual statement lines of business without being able to show that there was no more appropriate basis for measurement. In response to the prior report on examination the Company indicated that it was in the process of implementing a new method of allocating general expenses between companies and also among major annual statement lines of business that would follow the guidelines of Department Regulation No. 33.

The examiner reviewed the Company's workpapers supporting its new method of allocating general expenses between companies and among major annual statement lines of business. The review indicated that time spent by various personnel was the basis for the allocation of general expenses between companies, although there was insufficient documentation to support such as noted earlier in this report. The review also indicated that the Company allocated general expenses among major annual statement lines of business using a percentage of reserves for each product or line of business over the total reserves. Allocating general expenses among major annual statement lines of business using a percentage of reserves constitutes using an unacceptable general index for allocating such expenses. In addition, the method employed by the Company to allocate general expenses between companies differed from the method used by the Company to allocate expenses by major annual statement lines of business.

The Company once again violated Section 91.4(f)(5) of Department Regulation No. 33 when it used a general index to allocate general expenses among major annual statement lines of business.

The Company also violated Section 91.4(a)(5) of Department Regulation No. 33 by failing to treat the allocation of general expenses between companies in the same manner as if made for major annual statement lines of business.

C. Management

The Company's by-laws provide that the board of directors shall be comprised of not less than 13 and not more than 36 directors. Directors are elected for a period of one year at the annual meeting of the stockholders held on the last day of February each year or on such other date as may be fixed by the board of directors. As of December 31, 2004, the board of directors consisted of 13 members. Meetings of the board are held annually.

The 13 board members and their principal business affiliation, as of December 31, 2004, were as follows:

Name and Residence	Principal Business Affiliation	Year First Elected
Edward J. Babbit Cincinnati, OH	Secretary National Integrity Life Insurance Company Vice President Government Relations Senior Counsel Western and Southern Life Insurance Company	2002
John F. Barrett Cincinnati, OH	Chairman of the Board National Integrity Life Insurance Company President, Chief Executive Officer and Chairman of the Board Western and Southern Life Insurance Company	2000
George R. Bunn, Jr.* New York, NY	Attorney	2002
Dennis L. Carr Prospect, KY	Executive Vice President, Chief Actuary and Chief Financial Officer National Integrity Life Insurance Company	1998
Daniel J. Downing Warwick, NY	Vice President National Integrity Life Insurance Company	1988
Eric C. Fast* Rye, NY	President, Chief Operating Officer and Director Crane Company	2000
Dale P. Hennie* Cincinnati, OH	Retired	2000

Name and Residence	Principal Business Affiliation	Year First Elected
John R. Lindholm Louisville, KY	President and Chief Executive Officer National Integrity Life Insurance Company	1997
Cameron F. MacRae III* New York, NY	Attorney Leboeuf, Lamb, Greene and MacRae	2000
Newton P. S. Merill* New York, NY	Senior Executive Vice President Bank of New York	2000
Robert L. Walker Cincinnati, OH	Senior Vice President and Chief Financial Officer Western and Southern Life Insurance Company	2000
William J. Williams Cincinnati, OH	Director Western and Southern Life Insurance Company	2000
Donald J. Wuebbling Cincinnati, OH	Senior Vice President and General Counsel Western and Southern Life Insurance Co.	2000

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

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

Name	Title
John F. Barrett	Chairman of the Board
John R. Lindholm	President and Chief Executive Officer
Dennis L. Carr	Executive Vice President, Chief Actuary and Chief Financial Officer
Edward J. Babbitt	Secretary
James G. Kaiser	Executive Vice President
William H. Guth	Senior Vice President
Edward J. Haines	Senior Vice President
Kevin L. Howard*	Senior Vice President
Jill R. Keinsley	Senior Vice President
Barry P. Meyers	Senior Vice President
Kenneth A. Palmer	Senior Vice President
Nicholas P. Sargen	Senior Vice President

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

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 eight states, namely Connecticut, Florida, Maine, New Hampshire, New York, Ohio, Rhode Island, and Vermont, as well as the District of Columbia. In 2004, 93.4% of annuity considerations and deposit type funds were received from the state of New York. Policies are written on a non-participating basis.

The Company's principal products sold during the examination period were fixed and variable annuities that consisted of single premium deferred annuity, single premium immediate annuity, and flexible premium variable annuity contracts. The Company offers guaranteed rate options with both its fixed and variable annuities. The guaranteed rate option allows a fixed annuity contract holder to lock in a fixed rate for a two to ten year period. In addition, the Company offers short term options that are available only with its variable annuity contracts. The short term option provides the contract holder with a guaranteed interest rate on its contributions; however, contributions must be transferred to other investment options in equal monthly or quarterly installments within six months or one year.

The Company's target markets for both its fixed and variable annuity products generally are middle to upper income individuals over the age of fifty who want to save for retirement with financial products that provide the benefit of tax-deferred growth.

The Company's agency operations are conducted on a general agency basis. Independent broker-dealer firms, stock brokerage firms, independent agents and financial institutions market the Company's fixed and variable annuity products.

E. Reinsurance

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

The maximum retention limit for individual life contracts is $250,000. The total face amount of life insurance ceded as of December 31, 2004 was $67,518,679, which represents 5.4% of the total face amount of life insurance in force.

The total face amount of life insurance assumed as of December 31, 2004, was $1,100,069,118. As of January 1, 2004, the Company assumed $853,541,463 of life insurance from RGA Reinsurance Company of Barbados; the reinsured amount represents 77.59% of the total amount of reinsurance assumed as of December 31, 2004.

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, 2001	December 31, 2004	Increase (Decrease)
Admitted assets	$1,558,665,411	$2,730,232,130	$1,171,566,719
Liabilities	$1,499,757,886	$2,632,094,846	$1,132,336,960
Common capital stock	$ 2,000,000	$ 2,000,000	$ 0
Gross paid in and contributed surplus	101,069,159	206,370,849	105,301,690
Unassigned funds (surplus)	(44,161,634)	(110,233,565)	(66,071,931)
Total capital and surplus	$ 58,907,525	$ 98,137,284	$ 39,229,759
Total liabilities, capital and surplus	$1,558,665,411	$2,730,232,130	$1,171,566,719

The majority (72.7%) of the Company's admitted assets, as of December 31, 2004, was derived from Separate Accounts.

The Company's invested assets as of December 31, 2004, exclusive of separate accounts, were mainly comprised of bonds (81.7%), cash and short-term investments (11.5%) and policy loans (5.3%). The majority (94.8%) of the Company's bond portfolio, as of December 31, 2004, was comprised of investment grade obligations.

Approximately $728 million of the $1.1 billion increase in assets and liabilities is attributable to net positive cash flows, which represents sales less surrenders and deaths. Another $100 million of the increase is attributable to favorable fund performance during the examination period. Unrealized market value appreciation on investments backing the Company's market value adjusted annuities, which are held in the separate account, increased by approximately $53.3 million during the period. This growth in the business of the Company, coupled with approximately $105 million of capital contributions from Integrity and investment growth, has contributed to the significant increase in assets and liabilities from December 31, 2001 to December 31, 2004.

The following indicates, for each of the years listed below, the amount of life insurance issued and in force by type (in thousands of dollars):

	Individual Whole Life	
Year	Issued	In Force
2002	$0	$420,734
2003	$0	$409,630
2004	$0	$1,250,822

The large increase in individual whole life insurance in-force in 2004 was a result of the assumed reinsurance agreement dated January 2004 with RGA Reinsurance Company of Barbados totaling $854,541,463.

The following has been extracted form the Exhibits of annuities in the filed annual statement for each year under review:

	Ordinary Annuities		
	2002	2003	2004
Outstanding, end of previous year	25,756	32,346	36,428
Issued during the year	8,241	6,163	6,261
Other net changes during the year	(1,651)	(2,081)	(2,287)
Outstanding, end of current year	32,346	36,428	40,402

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:

	2002	2003	2004
Ordinary:			
Life insurance	$ 2,373,298	$1,824,922	$ 1,707,772
Individual annuities	(19,625,043)	1,106,397	(3,658,514)
Supplementary contracts	(1,142,386)	512,852	165,150
Total ordinary	$(18,394,131)	$3,444,171	$(1,785,592)

The fluctuations in net gains (losses) are mainly due to fluctuations in the Company's individual annuity line of business. Two unusual items were the primary cause of the $19.6 million net operational loss in 2002. First, the Company suffered $9.8 million of credit related unrealized losses on the assets supporting its market value adjusted annuities that are held in its separate accounts. Secondly, the Company was required to hold an additional $7 million of reserves for its market value adjusted annuities in order to pass cash flow testing.

The loss in 2004 in the individual annuity line of business was attributable to: the strain from issuing new business, as premiums were higher in 2004 as compared to 2003; $2.2 million of credit related unrealized losses on the assets supporting its market value adjusted annuities held in its separate accounts, as compared to $0.5 million of such losses in 2003; and a significant increase in state taxes in 2004 totaling $1.4 million.

The variation in net gains (losses) for supplementary contracts in 2003 as compared to 2002 was a result of an increase in investment income allocated to this line of business due to growth in supplementary contract customer deposits relative to other general account products.

5. FINANCIAL STATEMENTS

The following statements show the assets, liabilities, capital, surplus and other funds 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 capital and surplus account for each of the years under review. The examiner's review of a sample of transactions did not reveal any differences that 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, CAPITAL, SURPLUS AND OTHER FUNDS AS OF DECEMBER 31, 2004

Admitted Assets

Bonds	$ 595,592,848
Stocks:	
Preferred stocks	9,570,474
Mortgage loans on real estate:	
First liens	682,650
Cash, cash equivalents and short term investments	84,016,332
Contract loans	38,468,139
Receivable for securities	842,780
Investment income due and accrued	7,630,708
Net deferred tax asset	8,304,331
From Separate Accounts, Segregated Accounts and Protected Cell Accounts	1,985,123,868
Total admitted assets	$2,730,232,130

Liabilities, Capital, Surplus and Other Funds

Aggregate reserve for life policies and contracts	$ 637,881,844
Liability for deposit-type contracts	10,092,829
Contract claims:	
Life	40,000
Contract liabilities not included elsewhere:	
Other amounts payable on reinsurance	249,919
General expenses due or accrued	80,313
Transfers to Separate Accounts due or accrued	(14,934,258)
Taxes, licenses and fees due or accrued, excluding federal income taxes	30,069
Amounts withheld or retained by company as agent or trustee	36,980
Remittances and items not allocated	816,631
Miscellaneous liabilities:	
Asset valuation reserve	20,033,808
Payable to parent, subsidiaries and affiliates	1,946,095
Payable for securities	23,597,359
From Separate Accounts statement	1,952,223,257
Total liabilities	$2,632,094,846
Common capital stock	$ 2,000,000
Gross paid in and contributed surplus	206,370,849
Unassigned funds (surplus)	(110,233,565)
Surplus	$ 96,137,284
Total common capital stock and surplus	$ 98,137,284
Total liabilities, common capital stock, and surplus	$2,730,232,130

B. CONDENSED SUMMARY OF OPERATIONS

	2002	2003	2004
Premiums and considerations	$525,230,317	$375,070,452	$421,334,700
Investment income	29,419,710	30,559,507	32,257,415
Miscellaneous income	8,662,828	9,170,813	9,553,346
Total income	$563,312,855	$414,800,772	$463,145,461
Benefit payments	$160,572,083	$207,167,409	$239,402,884
Increase in reserves	(29,400,533)	68,242,223	139,431,150
Commissions	32,269,422	24,412,469	28,933,819
General expenses and taxes	10,765,868	12,387,457	13,685,887
Net transfers to Separate Accounts	409,336,084	107,166,326	48,650,076
Miscellaneous deductions	(1,835,938)	(63,404)	(4,004,448)
Total deductions	$581,706,986	$419,312,480	$466,099,368
Net gain (loss)	$ (18,394,131)	$ (4,511,708)	$ (2,953,908)
Federal and foreign income taxes incurred	0	(7,955,880)	(1,168,316)
Net gain (loss) from operations before net realized capital gains	$ (18,394,131)	$ 3,444,172	$ (1,785,592)
Net realized capital gains (losses)	(4,951,237)	480,367	(2,225,633)
Net income	$ (23,345,368)	$ 3,924,539	$ (4,011,225)

The increase in premiums and considerations in 2002 was primarily due to poor stock market performance during the year that prompted customers to migrate to fixed annuity products. This environment, coupled with increased marketing efforts by the Company to promote fixed products, contributed to higher levels of premiums for the Company's fixed annuities. Conversely, the decrease in annuity sales in 2003 was due to historically low interest rates, which made these products less attractive to consumers. The 2004 increase was primarily attributable to increased sales of AnnuiQuest, a single premium deferred annuity product offered through the Company's bank marketing channel.

The large decrease in net transfers to separate accounts in 2003 as compared to 2002 was primarily attributable to a decrease in the sale of, and transfers into, market value adjusted annuities in 2003 as compared to 2002 combined with an increase in surrenders of, and benefits paid on, market value adjusted annuities.

The variations in net realized capital gains (losses) were primarily due to an increase in bond portfolio defaults and other asset impairments recorded during 2002 and 2004.

C. CAPITAL AND SURPLUS ACCOUNT

	2002	2003	2004
Capital and surplus, December 31, prior year	$ 58,907,525	$ 71,106,783	$ 91,899,124
Net income	$(23,345,368)	$ 3,924,539	$ (4,011,225)
Change in net unrealized capital gains (losses)	6,638	(92,379)	94,510
Change in net deferred income tax	7,237,549	7,933,289	6,875,407
Change in non-admitted assets and related items	(11,821,250)	(2,381,291)	(7,472,671)
Change in reserve valuation basis	0	0	(10,100,000)
Change in asset valuation reserve	(12,461,904)	(2,086,303)	(383,702)
Surplus (contributed to), withdrawn from Separate Accounts during period	7,900,611	0	0
Other changes in surplus in Separate Accounts statement	(24,798,631)	(11,505,058)	(3,764,159)
Cumulative effect of changes in accounting Principles	14,179,924	0	0
Capital changes:			
Paid in	55,301,690	25,000,000	25,000,000
Other changes in assigned surplus	0	(456)	0
Net change in capital and surplus for the year	$ 12,199,258	$ 20,792,341	$ 6,238,160
Capital and surplus, December 31, current year	$ 71,106,783	$ 91,899,124	$ 98,137,284

The primary reason for the fluctuation in the change in non-admitted assets and related items was due to non-admitted deferred taxes. The Company did not record deferred taxes until January 1, 2002.

With respect to the change in reserve valuation basis, the Company strengthened reserves by $10.1 million in 2004 for structured settlements. The Company voluntarily increased reserves because the structured settlement block of business was expected to incur material future statutory losses under the previous reserve level.

The large fluctuation in the change in asset valuation reserve (“AVR”) in 2002 was primarily due to the Company recording approximately $22 million of reserve strengthening for cash flow testing purposes, of which $15.1 million consisted of a voluntary contribution to the AVR, and $7 million as an increase to miscellaneous reserves. Reserve strengthening was necessary so that the Company could issue an actuarial opinion for the reserves supporting the Company’s market value adjusted annuities.

During 2002, the Company adopted NAIC statutory codification effective January 1, 2001. However, the Department did not permit companies to take credit for deferred taxes until January 1, 2002. The initial adoption of codification and subsequent adjustment for deferred taxes was reported in “Cumulative effect of change in accounting principles” in the annual statement.

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.

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

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.

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

7. LOCATION OF COMPANY RECORDS

Section 325(a) of the New York Insurance Law states, in part:

> "Every domestic insurer . . . shall . . . keep and maintain at its principal office in this state . . . its books of account and . . . the minutes of any meetings of its shareholders, policyholders, board of directors and committees thereof . . ."

The Company did not maintain its books of account and certain board committee meeting minutes at its principal office in this state. The books of account that were not maintained at the Company's principal office in this state included quarterly and year-end trial balances, general ledgers, investment ledgers, journals, cash books, and subsidiary ledgers. The board committee meeting minutes that were not maintained at the Company's principal office in this state were the audit and independent director committee minutes, and the interest rate committee minutes.

The Company's Administrative Services Cost Sharing Agreement with Integrity indicates that the "Provider shall maintain acceptable backup (hard copy or any durable medium as long as the means to access the durable medium is also maintained at Company's principal office in New York) of the records constituting Company's books of account. Such backup shall be forwarded to Company on a monthly basis and shall be maintained by Company at its principal office in New York."

The Company violated Section 325(a) of the New York Insurance Law by failing to keep and maintain its books of account and certain board committee meeting minutes at its principal office in this state. A similar violation appeared in the prior Report on Examination. The Company is also in violation of the terms of its filed service agreement.

8. INVESTMENT POLICY STATEMENT

A review of the minutes of the board of directors indicated that a written investment plan with specific guidelines as to the quality, maturity, and the diversification of investments was never adopted during the examination period under review.

During 2001, the Company submitted and the Department approved an Investment Advisory Agreement, between the Company and Fort Washington. The agreement allows Fort Washington to act as an investment advisor to the Company and to perform services with regard to the Company's portfolio of invested assets, including preparing necessary research reports, and making recommendations with respect to the purchases and sales of particular securities. These services are to be performed in conformity with the guidelines as set forth in Exhibit A ("Investment Objectives, Policies and Restrictions") and in Exhibit B ("Investment Guidelines") of the agreement. However, the Company could not provide evidence that the agreement was approved by the Company's board of directors or that guidelines outlined in Exhibits A and B were ever updated during the examination period.

As a result, the Company should adopt an investment policy statement which specifically addresses the portfolio's investment objectives, constraints and strategies. A formal investment policy provides the Company and its management (board and senior officers) the ability to demonstrate fiduciary competence with regard to the management of policyholder funds (surplus). The investment policy guidelines should also clearly define: 1) management's risk tolerance; 2) the risk and return objectives of senior management with regard to the portfolio (i.e. horizon; liquidity; and tax, legal and regulatory requirements); and 3) appropriate benchmarks that enable management to assess the performance of Fort Washington.

The examiner recommends that the Company's board of directors adopt a formal written investment policy statement that specifically addresses the portfolio's investment objectives, constraints and strategies.

9. DISASTER RECOVERY PLAN

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.

It is noted that during the examination period under review the Company developed a new business continuity plan that incorporated disaster recovery within the framework of the plan. It is also noted that the plan addressed 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. Similarly, the plan identified the recovery of critical business processes, 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. However, the plan does not contain provisions to ensure periodical testing.

The Company indicated that in February 2005, the first phase of Disaster Recovery Plan testing was performed on ViewStar and RightFax, two systems that allow the Company to accept documents and requests from customers and others with which the Company conduct's its business. The Company indicated that it placed emphasis on the scanning and index systems because that allows them to time stamp everything that comes in so that it can backdate it properly when the systems are up again and fully functioning.

Similarly, the Company indicated that in August 2005 the second phase of Disaster Recovery Plan testing (including retesting of previously reviewed systems) would be performed. Recovery of the mainframe will also be tested, including the LIDP Administrator system, a recently installed annuity administration system.

The examiner recommends that the Company formally incorporate as part of its Business Continuity - Disaster Recovery Plan periodical testing of the Plan and that the Company maintain test results indicating problems found or successful completion.

10. PRIOR REPORT SUMMARY AND CONCLUSIONS

Following are the violations, recommendations and comments contained in the prior report on examination and the subsequent actions taken by the Company in response to each citation:

Item	Description
A	The Company violated Section 1201(a)(5)(B)(v) of the New York Insurance Law and Article 5 of its charter for having less than 13 directors. George R. Bunn, Jr. and Edward J. Babbitt were appointed to serve on the Company's Board of Directors, bringing the total number of directors to thirteen. The appointments were effective March 15, 2003.
B	The Company violated Section 91.4(c)(2) of Department Regulation No. 33 by incorrectly including the Separate Account reserves as a basis for the allocation and distribution of net investment income to major annual statement lines of business. The Company no longer includes the Separate Account reserves as a basis for the allocation and distribution of net investment income to major annual statement lines of business.
C	The Company violated Section 91.4(f)(5) of Department Regulation No. 33 when it used a general index to allocate expenses among major annual statement lines of business without being able to show that there was no more appropriate basis for measurement. The Company again violated Section 91.4(f)(5) of Department Regulation No. 33 when it used a general index to allocate expenses among major annual statement lines of business.
D	The examiner recommended that the Company adopt a method of allocation that is in line with the requirements of Department Regulation No. 33. The Company adopted a method of allocating its expenses between companies that is in line with the requirements of Department Regulation No. 33. However, the Company's method of allocating expenses among major annual statement lines of business is in violation of Department Regulation No. 33.

Item	Description
E	The examiner recommended that the Company maintain the form indicating the manner and extent of distribution of its advertising file at its home office. The Company now maintains a form indicating the manner and extent of distribution of its advertisements at its home office.
F	The Company violated Section 219.4(e) of Department Regulation No. 34-A when it stated in two advertisements that a death benefit is also included with the policy at no additional cost. The Company no longer states in its advertisements that a death benefit is also included with the policy at no additional cost.
G	The examiner commented that analysis of the Company's response to Supplement No.1 to Department Circular Letter No. 19 (2000) was not possible because the Company stated that no workpapers were produced. Department Circular Letter No. 19 (2000) was not part of the scope of the current examination.
H	The Company violated Section 325(a) of the New York Insurance Law when it did not keep and maintain its books of account at its principal office in this state. The Company again violated Section 325(a) of the New York Insurance Law by failing to keep and maintain its books of account at its principal office in this state. (See item 7 of this report)
I	The Company agreed to calculate the guaranteed minimum death benefit reserves in accordance with Department Regulation No. 151 for the September 2003 quarterly statement. The Company also agreed to implement a more sophisticated competitor rate formula for its MVAA in 2003. The Company calculates the guaranteed minimum death benefit reserves in accordance with Department Regulation No. 151 and has implemented a more sophisticated competitor rate formula for its MVAA.

11. SUMMARY AND CONCLUSIONS

Following are the violations and recommendations contained in this report:

Item	Description	Page No(s).
A	The examiner recommends that the Company comply with terms of the Expense Reimbursement and Administrative Services Agreement with Touchstone as filed and approved by the Department.	6-7
B	The Company violated Section 1505(b) of the New York Insurance Law by failing to maintaining records with sufficient detail to support the reasonableness of the charges or fees paid under its inter-company service agreements with Touchstone, including the charges or fees that were charged indirectly to Integrity on behalf of the Company.	7-8
C	The Company violated Section 91.4(a)(2) of Department Regulation No. 33 by failing to provide documentation that supports the actual basis of the allocation of expenses between companies.	8-9
D	The Company violated Section 91.4(f)(5) of Department Regulation No. 33 when it used a general index to allocate general expenses among major annual statement lines of business. A similar violation appeared in the prior report on examination.	9-10
E	The Company violated Section 91.4(a)(5) of Department Regulation No. 33 by failing to treat the allocation of general expenses between companies in the same manner as if made for major annual statement lines of business.	9-10
F	The Company violated Section 325(a) of the New York Insurance Law by failing to keep and maintain its books of account and certain board committee meeting minutes at its principal office in this state. A similar violation appeared in the prior report on examination.	24
G	The examiner recommends that the Company's board of directors adopt a formal written investment policy statement that specifically addresses the portfolio's investment objectives, constraints and strategies.	25
H	The examiner recommends that the Company formally incorporate as part of its Business Continuity - Disaster Recovery Plan periodical testing of the Plan and that the Company maintain test results indicating problems found or successful completion.	26

Respectfully submitted,

/s/

Stanley Chan
Senior Insurance Examiner

STATE OF NEW YORK)
)SS:
COUNTY OF NEW YORK)

Stanley Chan, being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.

/s/

Stanley Chan

Subscribed and sworn to before me

this__________ day of ____________________2005.

APPOINTMENT NO. 22341

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:

STANLEY CHAN

as a proper person to examine into the affairs of the

NATIONAL INTEGRITY LIFE INSURANCE COMPANY

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

COMPANY

with such other information as he 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

Acting Superintendent