STATE OF NEW YORK INSURANCE DEPARTMENT

REPORT ON EXAMINATION

OF THE

FIRST REHABILITATION LIFE INSURANCE COMPANY OF AMERICA

CONDITION: December 31, 2006

DATE OF REPORT: June 29, 2007

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THE FIRST REHABILITATION LIFE INSURANCE COMPANY

OF AMERICA

AS OF

DECEMBER 31, 2006

DATE OF REPORT:	JUNE 29, 2007
EXAMINER:	HENRY WONG

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

Eliot Spitzer
Governor

Eric R. Dinallo
Superintendent

June 29, 2007

Honorable Eric R. Dinallo
Superintendent of Insurance
Albany, New York 12257

Sir:

In accordance with instructions contained in Appointment No. 22576, dated October 30, 2006 and annexed hereto, an examination has been made into the condition and affairs of The First Rehabilitation Life Insurance Company of America, hereinafter referred to as "the Company," at its home office located at 600 Northern Boulevard, Great Neck, New York 11021.

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, 2006 filed annual statement. (See item 5 of this report)

The examiner recommends that the Company record and maintain minutes for the Audit and Review Committee meetings, contemporaneously with the occurrence of the meetings, in the future. (See item 3 of this report)

The examiner recommends that the Company comply with Section 216.4(e) of Department Regulation No. 64 and maintain a log of all consumer complaints including those that the Company receives directly from policyholders. (See item 8 of this report)

2. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 2003. This examination covers the period from January 1, 2004 through December 31, 2006. As necessary, the examiner reviewed transactions occurring subsequent to December 31, 2006 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, 2006 to determine whether the Company's 2006 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
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 violation, recommendations and comment contained in the prior report on examination. The results of the examiner's review are contained in item 9 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 in New York as a stock insurance company under the name of The First Rehabilitation Insurance Company of America on August 12, 1971. The Company was licensed on August 8, 1972 to write accident and health insurance as specified in paragraph 3 of Section 1113(a) of the New York Insurance Law and commenced business on November 1, 1972. In January 1997, the Company amended its charter to include the writing of life insurance and annuities as specified in paragraphs 1 and 2 of Section 1113(a) of the New York Insurance Law. The name of the Company was changed to The First Rehabilitation Life Insurance Company of America effective January 1, 1997. As of December 31, 2006, the Company reported common capital stock of $2,000,000, provided through the sale of 20,000 shares of common stock with a par value of $100 per share, and paid in and contributed surplus of $5,400,000.

B. Holding Company

The Company is a wholly owned subsidiary of Rehab Services Corporation ("Rehab Services"), a New York domiciled insurance holding company. The major stockholders of Rehab Services are Seth Goldberg (26⅓%), Bruce Goldberg (26⅓%), and the estate of Glenn Goldberg (26⅓%).

The Company and Rehab Services file a consolidated tax return. The Company has a consolidated tax allocation agreement on file with the Department in accordance with Department Circular Letter No. 33 (1979).

C. Management

The Company's by-laws provide that the board of directors shall be comprised of not less than 9 and not more than 21 directors. Directors are elected for a period of one year at the annual meeting of the stockholders held in December of each year. As of December 31, 2006, the board of directors consisted of 10 members. Meetings of the board are held quarterly.

The 10 board members and their principal business affiliation, as of December 31, 2006, were as follows:

Name and Residence	Principal Business Affiliation	Year First Elected
John Baldwin Pleasantville, NY	President The First Rehabilitation Life Insurance Company of America	1981
Anthony Barbiero* East Islip, NY	Attorney Anthony Barbiero, P.C.	1972
Mehmet Cetin* Sarasota, FL	Retired	1972
Gerald Dolman* Manhasset, NY	President Administrators of the Professions, Inc.	1998
Bruce Goldberg East Hills, NY	Physician	1979
Seth Goldberg Roslyn, NY	Physician	1972
Michelle Goldberg New York, NY	Housewife	2004
Alvin Lefkowitz Rockville Centre, NY	Secretary The First Rehabilitation Life Insurance Company of America	1972
Norman Mandel Brooklyn, NY	Treasurer The First Rehabilitation Life Insurance Company of America	1995
Morton Povman* Forest Hills, NY	Attorney Morton Povman, P.C.	1972

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

In January 2007, Bruce Goldberg passed away; a replacement has not been elected.

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

The Company did not maintain any meeting minutes documenting the fact that the Audit and Review Committee met during the examination period. The Company stated that although no minutes were taken, the Committee did meet as required. At the examiner's request, the Company recreated minutes for the Audit and Review Committee meetings based on the notes and recollections of the committee members.

The examiner recommends that the Company record and maintain minutes for the Audit and Review Committee meetings, contemporaneously with the occurrence of the meetings, in the future.

The following is a listing of the principal officers of the Company as of December 31, 2006:

Name	Title
John Baldwin	President
Robert Slack	Chief Financial Officer and Controller
Alvin Lefkowitz	Secretary
Fern Summer*	Assistant Secretary
Norman Mandel	Treasurer

* 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 and is licensed to transact business in 16 states. In 2006, substantially all premiums (88.3%) were received from New York. Policies are written on a non-participating basis.

The Company's primary product is the New York State Statutory Disability Benefit ("DBL"). The Company also offers group term life and group accident and health coverage including: long term disability, two excess major medical policies (an excess group major medical policy (XGMM) and an excess group medical reimbursement policy (GMRP)), stop loss, dental and vision plans.

The Company's agency operations are conducted on both a general agency and broker basis. Group accident and health insurance plans are sold by brokers and agents and group term life insurance is sold exclusively through agents.

E. Reinsurance

As of December 31, 2006, the Company had three reinsurance treaties in effect with three companies, all of which were authorized or accredited. Long term disability policies are ceded to Union Security Life Insurance Company of New York on an automatic quota share basis with the Company retaining 20% of each risk.

Group term life insurance policies, which have a maximum face amount of $300,000, are ceded to Swiss Re Life & Health America Inc. on an automatic quota share basis. The maximum retention limit for the Company is 50% of the first $100,000 per person.

Stop loss policies are ceded on an automatic quota share basis with the Company retaining 20% of the risk up to $1,000,000. Policies with a lifetime maximum greater than $1,000,000 but less than or equal to $5,000,000, are reinsured 100% of up to $4,000,000 in excess of $1,000,000, for specific medical expense.

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 (decline) during the period under review:

	December 31, 2003	December 31, 2006	Increase (Decrease)
Admitted assets	$72,081,952	$93,977,575	$ 21,895,623
Liabilities	$29,140,905	$61,467,585	$ 32,326,680
Common capital stock	$ 2,000,000	$ 2,000,000	$ 0
Gross paid in and contributed surplus	4,000,000	5,400,000	1,400,000
Aggregate write-ins for special surplus funds	0	(238,395)	(238,395)
Unassigned funds (surplus)	36,941,047	25,348,387	(11,592,660)
Total capital and surplus	$42,941,047	$32,509,992	$(10,431,055)
Total liabilities, capital and surplus	$72,081,952	$93,977,577	$ 21,895,625

The significant increase in assets was due to the growth of the accident and health line of business during the examination period.

The significant increase in liabilities is due to the establishment of an accrual in the amount of $32,263,639 which represents premium refunds for the years 2004, 2005 and 2006. By letter dated January 16, 2007, the Department accepted the Company's plan to issue premium credits and cash refunds totaling $22,233,941 to certain policyholders who had small group community rated DBL, excess group major medical and/or vision benefit policies in force during calendar years 2004 and 2005 in order to meet the minimum loss ratio standards in Section 52.45(f) of Department Regulation No. 62. In addition, for the calendar years 2006, 2007 and 2008, any failure to meet the applicable minimum loss ratio standard will result in the issuance of premium credits or cash refunds to the extent that is necessary for the Company to meet the corresponding minimum loss ratio standard.

The increase in gross paid in and contributed surplus is due to a deferred compensation arrangement between the Company's president and the Company's parent, RSC. In 2002, the President of the Company received shares of preferred stock of RSC in return for services rendered to the Company. The Company adjusts the paid in capital account by the estimated fair value of the stock annually.

The Company's invested assets as of December 31, 2006, were mainly comprised of bonds (87.7%) and cash and short-term investments (11.7%). The company's entire bond portfolio, as of December 31, 2006, was comprised of investment grade obligations.

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:

	2004	2005	2006
Group Life	$ 117,177	$ 175,965	$ 126,462
Group Accident and health	$3,461,270	$5,911,614	$(19,253,230)
Total	$3,578,447	$6,087,579	$(19,126,768)

The significant decrease in operating income for the accident and health line in 2006 was due to the premium credit and cash refund agreement with the Department.

The following ratios, applicable to the accident and health business of the Company, have been extracted from Schedule H for each of the indicated years:

	2004	2005	2006
Premiums earned	100.0%	100.0%	100.0%
Incurred losses	65.3%	55.9%	100.2%
Commissions	12.2	14.6	16.3
Expenses	19.9	21.4	36.6
	97.4%	91.9%	153.1%
Underwriting results	2.6%	8.1%	(53.1)%

The significant increase to the ratio of incurred losses to premium earned in 2006 was due to the impact of the Plan to Issue Premium Credits or Cash Refunds.

5. FINANCIAL STATEMENTS

The following statements show the assets, liabilities, capital and surplus as of December 31, 2006, as contained in the Company's 2006 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 which materially affected the Company's financial condition as presented in its financial statements contained in the December 31, 2006 filed annual statement.

A. ASSETS, LIABILITIES, CAPITAL AND SURPLUS AS OF DECEMBER 31, 2006

Admitted Assets

Bonds	$71,541,242
Common stocks	500,005
Cash, cash equivalents and short term investments	9,536,940
Investment income due and accrued	965,133
Uncollected premiums and agents' balances in the course of collection	8,331,815
Amounts recoverable from reinsurers	37,085
Net deferred tax asset	2,927,539
Electronic data processing equipment and software	137,816
Total admitted assets	$93,977,575

Liabilities, Capital and Surplus

Aggregate reserve for accident and health contracts	$10,126,806
Contract claims:	
Life	12,500
Accident and health	8,241,827
Premiums and annuity considerations for life and accident and health contracts received in advance	9,358,060
Contract liabilities not included elsewhere:	
Provision for experience rating refunds	2,816,000
Other amounts payable on reinsurance	22,710
Interest maintenance reserve	93,550
General expenses due or accrued	2,443,117
Taxes, licenses and fees due or accrued, excluding federal income taxes	(451,778)
Current federal and foreign income taxes	(3,771,499)
Amounts withheld or retained by company as agent or trustee	115,648
Miscellaneous liabilities:	
Asset valuation reserve	195,723
Payable to parent, subsidiaries and affiliates	1,282
Aggregate write-ins for liabilities	32,263,639
Total liabilities	$61,467,585
Common capital stock	$ 2,000,000
Gross paid in and contributed surplus	5,400,000
Aggregate write-ins for special surplus funds	(238,395)
Unassigned funds (surplus)	25,348,387
Surplus	$30,509,992
Total capital and surplus	$32,509,992
Total liabilities, capital and surplus	$93,977,577

B. CONDENSED SUMMARY OF OPERATIONS

	2004	2005	2006
Premiums and considerations	$70,031,236	$77,198,536	$ 45,979,581
Investment income	2,455,597	2,380,632	3,453,615
Commissions and reserve adjustments on reinsurance ceded	3,133,787	0	0
Miscellaneous income	318,450	339,897	356,835
Total income	$75,939,070	$79,919,065	$ 49,790,031
Benefit payments	$40,113,990	$42,642,256	$ 45,425,430
Increase in reserves	4,926,746	366,286	348,882
Commissions	11,699,231	11,296,699	7,497,903
General expenses and taxes	13,910,741	16,474,866	16,738,431
Miscellaneous deductions	126,218	0	0
Total deductions	$70,776,926	$70,780,107	$ 70,010,646
Net gain (loss)	$ 5,162,144	$ 9,138,958	$(20,220,615)
Dividends	0	0	0
Federal and foreign income taxes incurred	1,583,697	3,051,379	1,093,846
Net gain (loss) from operations before net realized capital gains	$ 3,578,447	$ 6,087,579	$(19,126,769)
Net realized capital gains (losses)	7,785	28,255	82,972
Net income	$ 3,586,232	$ 6,115,834	$(19,043,797)

The significant decrease in operating income for the accident and health line in 2006 was due to the premium credit and cash refund agreement with the Department. (See item 4 of this report)

C. CAPITAL AND SURPLUS ACCOUNT

	2004	2005	2006
Capital and surplus, December 31, prior year	$42,941,046	$44,053,640	$ 49,973,217
Net income	$ 3,586,232	$ 6,115,834	$(19,043,797)
Change in net unrealized capital gains (losses)	7,243	(2,698)	(80,920)
Change in net deferred income tax	90,036	372,441	4,340,109
Change in non-admitted assets and related items	(321,409)	245,194	(2,732,873)
Change in asset valuation reserve	(36,560)	(13,851)	(5,343)
Surplus adjustments:			
Paid in	1,896,844	77,584	(574,428)
Dividends to stockholders	(2,515,450)	(1,015,450)	0
Deferred compensation and other compensation adjustment	(1,594,342)	140,523	634,027
Net change in capital and surplus for the year	$ 1,112,594	$ 5,919,577	$(17,463,225)
Capital and surplus, December 31, current year	$44,053,640	$49,973,217	$ 32,509,992

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 group life claims, various accident and health claims and denied claims. 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. DISASTER RECOVERY AND BUSINESS CONTINUITY PLANS

The Company's disaster recovery plan indicated that the Company moved its disaster recovery facilities from 75 Greenery Avenue in Chappaqua, New York to 1 Penn Plaza, New York, New York in 2005, then subsequently relocated the site to 7 Penn Plaza in January 2007. The Company indicated that a test of the disaster recovery plan was conducted in June 2006; however, the Company did not maintain any documentation of the tests performed so that the examiner could not verify the results and sufficiency of the testing. In addition, the examiner's review of the Company's business continuity plan for all locations revealed that the Company has never tested this plan.

The examiner recommends that the Company record and maintain all documentation related to the testing of their disaster recovery plan.

The examiner recommends the Company test its business continuity plan for all locations periodically.

8. COMPLAINTS

Section 216.4(e) of Department Regulation No. 64 states:

> "As part of its complaint handling function, an insurer's consumer services department shall maintain an ongoing central log to register and monitor all complaint activity."

Based on the examiner's review of the Company's complaint log and complaint files, the Company did not record any direct consumer complaints; the complaint log included only consumer complaints filed with and received from the Department.

The examiner recommends that the Company comply with Section 216.4(e) of Department Regulation No. 64 and maintain a log of all consumer complaints including those the Company receives directly from policyholders.

9. PRIOR REPORT SUMMARY AND CONCLUSIONS

Following are the violations, recommendations and comment 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 was not in full compliance with Section 52.45(f) of Department Regulation No. 62 during the examination period since it did not meet for most years the minimum loss ratio standards for small group DBL, XGMM, and vision plans. Pursuant to a plan proposed by the Company and agreed to by the Department, the Company will issue premium credits or cash refunds for the three plans in question, i.e., small group DBL, XGMM and vision, in the aggregate amount of $22,233,941. The Company will provide the Department with interim reports for the purposes of monitoring the timely implementation of the plan. The Company started instituting premium credits with the March 2007 billing. The Company is furnishing the Department with quarterly reports related to the plan's implementation.
B	The Company violated Section 215.13(a) of Department Regulation No. 34 by failing to identify the applicable policy form number on all accident and health insurance advertisements. A review of the Company's accident and health advertisements indicated that the applicable policy form numbers were included on advertisements.
C	The examiner recommends that the Company comply with the terms of their GMPR-1 contract, specifically with respect to the time constraints related to the payment of annual retrospective experience refunds. A review of GMPR-1 contracts revealed that the Company is currently adhering to the time constraints with respect to the payment of annual retrospective experience refunds.

Item	Description
D	The examiner recommends that the Company establish and maintain an independent, adequately resourced, and competently staffed internal audit function to provide management and the audit committee with ongoing assessments of the Company's risk management processes and the accompanying system of internal control. The Company established an internal audit department with a full time internal auditor to provide management and the audit committee with ongoing assessments of the Company's risk management processes and the accompanying system of internal control.

10. SUMMARY AND CONCLUSIONS

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

Item	Description	Page No(s).
A	The examiner recommends that the Company record and maintain minutes for the Audit and Review Committee meetings, contemporaneously with the occurrence of the meetings, in the future.	6
B	The examiner recommends that the Company record and maintain all documentation related to the testing of their disaster recovery plan.	15
C	The examiner recommends the Company test its business continuity plan for all locations periodically.	15
D	The examiner recommends that the Company comply with Section 216.4(e) of Department Regulation No. 64 and maintain a log of all consumer complaints including those that the Company receives directly from policyholders.	16

Respectfully submitted,

_______/s/_________________
Henry Wong
Senior Insurer Examiner

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

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

_______/s/_________________
Henry Wong

Subscribed and sworn to before me

this__________ day of ____________________2007.

APPOINTMENT NO. 22576

STATE OF NEW YORK

INSURANCE DEPARTMENT

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

HENRY WONG

as a proper person to examine into the affairs of the

FIRST REHABILITATION LIFE INSURANCE COMPANY OF AMERICA

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 30th day of October, 2006

HOWARD MILLS
Superintendent of Insurance

Superintendent