

STATE OF NEW YORK INSURANCE DEPARTMENT
REPORT ON EXAMINATION
OF THE
LINCOLN LIFE AND ANNUITY COMPANY OF NEW YORK
AS OF
DECEMBER 31, 2001

DATE OF REPORT:

MARCH 5, 2003

EXAMINER:

EDEN M. SUNDERMAN

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

March 5, 2003

Honorable Gregory V. Serio
Superintendent of Insurance
Albany, New York 12257

Sir:

In accordance with instructions contained in Appointment No. 21932, dated August 27, 2002, and annexed hereto, an examination has been made into the condition and affairs of Lincoln Life and Annuity Company of New York, hereinafter referred to as “the Company,” or “LNY,” at its home office located at 100 Madison Street, Suite 1860, Syracuse, New York 13202.

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, 2001 filed annual statement. (See item 5 of this report)

Several violations of Section 1505(d)(3) of the New York Insurance Law, regarding inter-company service agreements, appear in this report. (See item 3B of this report)

The examiner recommends that the Company review its service agreements and revise them accordingly to accurately reflect how services are billed, how settlements are made, and which affiliate is actually providing specific services. (See item 3B of this report)

The Company violated Section 4228(e)(3)(C) of the New York Insurance Law by paying compensation in the form of training allowance subsidies to certain agents that did not qualify for such additional compensation. (See item 3D of this report)

Several violations of Department Regulation No. 33 regarding the allocation of net investment income and the allocation of expenses appear in this report. (See item 4 of this report)

Several violations of Section 2611(b) of the New York Insurance Law regarding required language that is missing from the Company's HIV consent forms appear in this report. (See item 8B of this report)

The examiner recommends that the Company enhance the scope of the audits and the reporting provided to management and the independent directors committee to more fully incorporate the Company into the ongoing assessments of its risk management processes and the accompanying system of internal control. (See item 6 of this report)

2. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 1998. This examination covers the period from January 1, 1999 through December 31, 2001. As necessary, the examiner reviewed transactions occurring subsequent to December 31, 2001 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, 2001 to determine whether the Company's 2001 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 violations 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

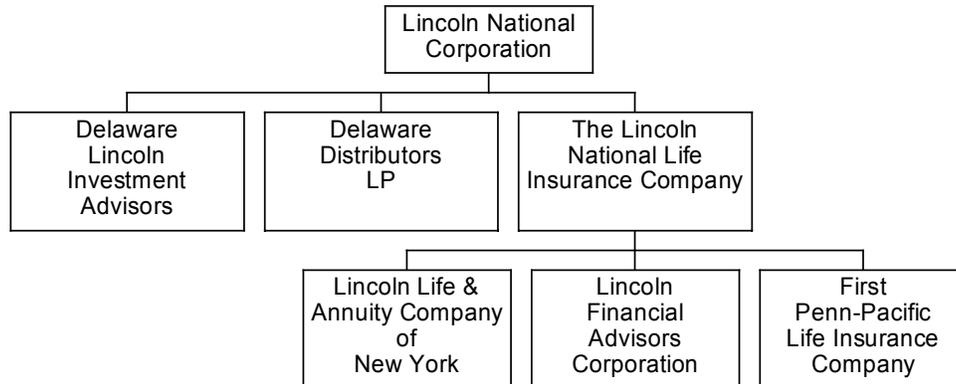
A. History

The Company was incorporated as a stock life insurance company under the laws of New York on June 6, 1996, was licensed on September 27, 1996 and commenced business on October 1, 1996. The Company was formed primarily to house the New York policyholders involved in its immediate parent's purchase of UNUM Corporation's group tax-sheltered annuity block of business. Initial resources of \$71,000,000, consisting of common (preferred) capital stock of \$2,000,000 and paid in and contributed surplus of \$69,000,000, were provided through the sale of 20,000 shares of common stock (with a par value of \$100 each) for \$3,550 per share.

B. Holding Company

The Company is a wholly owned subsidiary of The Lincoln National Life Insurance Company ("LNL"), an Indiana life insurance company. The ultimate parent of the Company is Lincoln National Corporation ("LNC"), a publicly traded financial services firm.

An organization chart reflecting the relationship between the Company and significant entities in its holding company system as of December 31, 2001 follows:



The Company had ten service agreements in effect as of December 31, 2001, which are summarized below.

1. An administrative service agreement with LNL effective January 1, 1998 whereby LNL provides various services, including accounting, data processing, tax, auditing, functional support services (actuarial, product research and development, legal

- services, employee relations services, reinsurance administration services, and other corporate services), policyholder service, premium collection services, underwriting and issue support, claims, public relations, advertising, sales and marketing services.
2. An administrative services agreement with LNL effective March 1, 1998 whereby LNY performs payment processing, legal, sales and marketing support with respect to the field operations of LNL in states other than New York, general strategic advice, financial and accounting services relative to the processing of the group annuity business, and other general administrative services with respect to the business of LNL.
 3. A common paymaster agreement with LNL whereby LNL prepares, distributes, and pays commissions and other compensation to agents and brokers utilized by both companies (LNY and LNL).
 4. An investment management agreement with Delaware Lincoln Investment Advisors (“DLIA”) effective January 1, 2001 whereby DLIA acts as the investment adviser with respect to the Company’s general account invested assets.
 5. A wholesaling agreement with Lincoln Financial Advisors Corporation (“LFA”) and Delaware Distributors, L.P. (“Delaware Distributors”) effective May 1, 2000, whereby LFA acts as the principal underwriter for the Company’s variable annuity and variable life insurance contracts and whereby Delaware Distributors agrees to act as a wholesaler for such variable annuity and variable life insurance contracts and recruits business firms to distribute such contracts.
 6. An administrative services agreement with LFA effective October 1, 1998 and amended January 1, 2000 whereby LFA provides sales and marketing review functions, and maintains a system of control for review of advertising materials.
 7. A principal underwriting agreement with LFA effective August 1, 1999 whereby LFA enters into selling agreements with broker-dealers for the distribution of LNY’s Separate Accounts contracts and acts as principal underwriter with respect to such Separate Accounts contracts.
 8. An administrative services agreement with First Penn-Pacific Life Insurance Company (“FPP”) effective October 31, 2000 whereby FPP provides general administration services, underwriting, premium processing, benefits administration,

commission processing, and sales and marketing services for the Company's term life business.

9. An administrative services agreement with FPP, whereby the Company performs payment processing services and other general administrative services on behalf of FPP.
10. A use of services and facilities agreement with Lincoln Financial Group, Inc. ("LFG") effective June 1, 1999, whereby LFG uses in its day to day operations, certain property, equipment and facilities of LNY.

Section 1505(d)(3) of the New York Insurance Law states, in part:

"The following transactions between a domestic controlled insurer and any person in its holding company system may not be entered into unless the insurer has notified the superintendent in writing of its intention to enter into any such transaction at least thirty days prior thereto, or such shorter period as he may permit, and he has not disapproved it within such period . . .
(3) rendering services on a regular or systematic basis . . ."

Section 3 of the filed administrative service agreement between the Company and FPP states, in part, the following with respect to charges for services provided by FPP:

"LNY agrees to reimburse FPP for services and facilities provided by FPP to LNY pursuant to this Agreement. The charge to LNY for such services and facilities shall be at cost and shall include all direct and directly allocable expenses, reasonably and equitably determined to be attributable to LNY by FPP, plus a reasonable charge for direct overhead, the amount of such charge for overhead to be agreed upon by the parties from time to time.

Subject to New York Insurance Department Regulation 33, the bases for determining such charges to LNY shall be those used by FPP for internal cost distribution including, where appropriate, time records prepared at least annually for this purpose . . .

Cost analyses will be made annually by FPP to determine, as closely as possible, the actual cost of services rendered and facilities made available to LNY hereunder. FPP shall forward to LNY the information developed by these analyses, and such information shall be used to develop bases for the distribution of expenses which more currently reflect the actual incidence of cost incurred by FPP on behalf of LNY. . . ."

Section 4 of the agreement states the following with respect to payment for services provided by FPP:

“FPP shall submit to LNY within thirty (30) days of the end of each calendar month a written statement of the amount estimated to be owed by LNY for services and the use of facilities pursuant to this Agreement in that calendar month, and LNY shall pay to FPP within thirty (30) days following receipt of such written statement the amount set forth in the statement.

Within thirty (30) days after the end of each calendar quarter, FPP will submit to LNY a detailed written statement of the charges due from LNY to Lincoln in the preceding calendar quarter, including charges not included in any previous statements, and any balance payable or to be refunded as shown in such statement shall be paid or refunded within fifteen (15) days following receipt of such written statement by LNY.”

A service agreement between the Company and LNL and the service agreement between the Company and LFA contain substantially similar language.

Section 4 of the service agreement between FPP and the Company states the following with respect to payment for services provided by the Company to FPP:

“LNY shall submit to FPP within thirty (30) days of the end of each calendar month a written statement of the amount estimated to be owed by FPP for services pursuant to this Agreement in that calendar month, and FPP shall pay to LNY within thirty (30) days following receipt of such written statement the amount set forth in the statement.

Within thirty (30) days after the end of each calendar quarter, LNY will submit to FPP a detailed written statement of the charges due from FPP to LNY in the preceding calendar quarter, including charges not included in any previous statements, and any balance payable or to be refunded as shown in such statement shall be paid or refunded within fifteen (15) days following receipt of such written statement by FPP.”

A service agreement between the Company and LNL contains substantially similar language.

Section 10 of the investment management agreement between DLIA and the Company states the following with respect to compensation for investment advisory services provided by DLIA to the Company:

“The compensation of DELAWARE [DLIA] for its investment advisory services shall be calculated and allocated in accordance with New York Insurance Department Regulation 33 and in accordance with the attached Schedule C.”

Schedule C of the investment management agreement with DLIA states:

“Fees for investment advisory services are based on DELAWARE’S [DLIA’S] actual internal costs incurred for the services provided and are charged, one month in arrears, to all portfolios based on average assets (book value) under management. Equity sub-advisory management fees are charged directly to the portfolios incurring the fees. External law firm expenses directly associated with the acquisition of an asset or resolution of a problem investment will be allocated to the portfolio incurring the fee.”

The review of holding company service agreements and related transactions revealed the following:

- The Company did not receive any billing statements in accordance with the provisions of the filed service agreements from affiliate entities that provided services during the examination period;
- Similarly, the Company did not provide any billing statements to FPP or LNL during the examination period in accordance with the provisions of the filed service agreements;
- Reimbursement for services provided by LFA to LNY are settled with LNL, not LFA directly. This method of settlement is not in accordance with the payment provision of the filed service agreement;
- Fees for investment advisory services are not charged directly to or deducted from the portfolio by DLIA. Instead, fees or charges related to the investment management of the Company’s general account are paid to LNC, the holding company. This manner of settlement is not in accordance with Schedule C of the filed service agreement; and
- The Company has four active service agreements with affiliates (i.e., LNL, LFA, Delaware Distributors and FPP) that provide sales and marketing (advertising) services. Based upon how the agreements are written, it is unclear which entity is to provide the sales and marketing services to the Company with respect to certain products.

The examiner recommends that the Company review its service agreements and revise them accordingly to accurately reflect how services are billed, how settlements are made, and what affiliate is actually providing services.

In addition to the aforementioned, the examiner further noted the following with respect to certain services between the Company and FPP during the examination period:

- The Company did not reimburse FPP for administrative services rendered pursuant to the filed service agreement. (The Company indicated in a response to the examiner that their best estimate of the net intercompany unpaid balance due FPP for such services is approximately \$56,000); and
- FPP did not reimburse the Company for payment processing and other general administrative services provided by the Company to FPP.

The Company violated Section 1505(d)(3) of the New York Insurance Law by failing to reimburse an affiliate for services provided on a regular and systematic basis, contrary to the filed administrative service agreement.

Further, the Company violated Section 1505(d)(3) of the New York Insurance Law by failing to bill or charge for services provided to an affiliate on a regular and systematic basis, contrary to the filed administrative service agreement.

In September 2002, the Company filed a tax allocation agreement with the Department. The agreement is under review as of the date of this report.

C. Management

The Company's by-laws provide that the board of directors shall be comprised of 13 directors. Directors are elected for a period of one year at the annual meeting of the stockholders held in May of each year. As of December 31, 2001, the board of directors consisted of 13 members. Meetings of the board are held immediately or 30 days thereafter the annual meeting of shareholders in May and at such intervals and on such dates as the board may designate or by means of unanimous written consent.

The 13 board members and their principal business affiliation, as of December 31, 2001, were as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>	<u>Year First Elected</u>
J. Patrick Barrett* Manlius, NY	Chairman and Chief Executive Officer CARPAT Investments	1996
Robert D. Bond Roanoke, IN	Vice President The Lincoln National Life Insurance Company	2000
Jon A. Boscia Gladwyne, PA	Chairman & Chief Executive Officer Lincoln National Corporation	1996
John H. Gotta Marlborough, CT	Chief Executive Officer and Executive Vice President The Lincoln National Life Insurance Company	1999
Barbara S. Kowalczyk Philadelphia, PA	Senior Vice President Lincoln National Corporation	1996
M. Leanne Lachman* New York, NY	Principal Lend Lease Real Estate Investments	1996
Louis G. Marcoccia* Cazenovia, NY	Senior Vice President for Business, Finance, and Administrative Services Syracuse University	1996
Gary W. Parker Farmington, CT	Senior Vice President The Lincoln National Life Insurance Company	2001
John M. Pietruski* Colts Neck, NJ	Chairman Texas Biotechnology Corporation	1996

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>	<u>Year First Elected</u>
Ron J. Ponder* Thousand Oaks, CA	Executive Vice President & Chief Information Officer WellPoint Health Networks, Inc.	2001
Mark E. Reynolds Fort Wayne, IN	Senior Vice President The Lincoln National Life Insurance Company	2001
Lorry J. Stensrud Lake Forest, IL	President Lincoln Life and Annuity Company of New York	2000
Richard C. Vaughan Bryn Mawr, PA	Executive Vice President and Chief Financial Officer Lincoln National Corporation	1996

* 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, 2001:

<u>Name</u>	<u>Title</u>
Lorry J. Stensrud	President
Eldon J. Summers	Treasurer
C. Suzanne Womack	Secretary
Janet Chrzan	Chief Financial Officer
Robert O. Sheppard*	Second Vice President and General Counsel

* 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 two states, namely New York and Indiana. In 2001, 91% of life premiums and 100% of annuity considerations were received from New York. Policies are written on a non-participating basis. The Company has a participating block of business on its books that was solely the result of acquiring individual participating life insurance policies and participating annuities from Aetna Life Insurance and Annuity Company (“ALIAC”), Aetna Life Insurance Company (“ALIC”), and Connecticut General Life Insurance Company (“CIGNA”) through indemnity reinsurance agreements.

The Company currently offers life insurance, annuity products, and qualified pension plan products and services to individuals and groups in New York. The Company’s portfolio includes term life, interest sensitive universal life and variable universal life insurance in addition to individual and group variable and fixed annuities.

The Company’s agency operations are conducted on both a general agency and brokerage basis, selling to affluent individuals and business owners.

Section 4228(e)(3)(C) of the New York Insurance Law states:

“An agent is eligible to receive such a training allowance subsidy, provided (i) such agent has earned less than twenty thousand dollars from the sale of policies and contracts cumulatively during the three years prior to such agent’s appointment, or (ii) less than twenty-five percent of such agent’s earned income has been received from the sale of policies and contracts during each of the three years prior to appointment.”

The Company paid training allowances to a limited number of agents who did not meet the eligibility requirements of Section 4228(e)(3)(C) of the New York Insurance Law. This compensation was independent of, and in addition to, any commissions that the agents might have earned.

The Company violated Section 4228(e)(3)(C) of the New York Insurance Law by paying compensation in the form of training allowance subsidies to certain agents who did not qualify for such additional compensation.

E. Reinsurance

Ceded

As of December 31, 2001, the Company had individual life and accident and health reinsurance cession agreements with 79 companies, of which 33 were authorized or accredited reinsurers. Reinsurance is placed on both an automatic and facultative basis.

The maximum retention limit for individual life contracts is \$500,000. The total face amount of life insurance ceded as of December 31, 2001, was \$6,996,530,644, which represents 61.3% of the total face amount of life insurance in force. Reserve credit taken for reinsurance ceded to unauthorized companies and reinsurance recoverables from unauthorized companies, totaling \$4,541,889, was partially supported by letters of credit totaling \$4,166,682.

As of December 31, 2001, the Company had an individual accident and health reinsurance retrocession agreement with one reinsurer, Metropolitan Life Insurance Company, (“Met Life”), dated October 31, 1999. Met Life agreed to reinsure, on an indemnity basis, all disability income contracts that the Company had acquired from CIGNA.

Assumed

As of December 31, 2001, the Company assumed individual and group life business and individual and group annuity business from four unaffiliated insurers. The total face amount of life insurance assumed as of December 31, 2001, was \$10,223,783,526, or 88.7% of the total face amount of life insurance in force.

As of December 31, 2001, the Company had assumed individual accident and health insurance from one insurer, CIGNA. The total reserves for assumed reinsurance as of December 31, 2001 was \$16,209,440. During 1999, the Company retroceded the entire CIGNA block of assumed accident and health contracts to Met Life.

The examiner requested policy level supporting accounting detail relating to the Company’s largest assumed and ceded reinsurance treaties. The Company was unable to provide policy level accounting detail that reconciled to the amounts reported in Schedule S of the annual statement.

The examiner recommends that the Company maintain policy level detail for its assumed and ceded reinsurance business that can be reconciled to the amounts reported in its filed annual statement.

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>1998</u>	December 31, <u>2001</u>	Increase (Decrease)
Admitted assets	<u>\$2,208,181,710</u>	<u>\$2,344,479,471</u>	<u>\$136,297,761</u>
Liabilities	<u>\$2,096,462,432</u>	<u>\$2,153,868,554</u>	<u>\$ 57,406,122</u>
Common capital stock	\$ 2,000,000	\$ 2,000,000	\$ 0
Gross paid in and contributed surplus	384,128,481	384,128,481	0
Unassigned funds (surplus)	<u>(274,409,203)</u>	<u>(195,517,564)</u>	<u>78,891,639</u>
Total capital and surplus	<u>\$ 111,719,278</u>	<u>\$ 190,610,917</u>	<u>\$ 78,891,639</u>
Total liabilities, capital and surplus	<u>\$2,208,181,710</u>	<u>\$2,344,479,471</u>	<u>\$136,297,761</u>

The Company's invested assets as of December 31, 2001, exclusive of Separate Accounts, were mainly comprised of bonds (82.3%), policy loans (9.0%) and mortgage loans (7.9%).

The majority (94.7%) of the Company's bond portfolio, as of December 31, 2001, 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:

	<u>1999</u>	<u>2000</u>	<u>2001</u>
Ordinary:			
Life insurance	\$20,811,253	\$ 2,582,034	\$ 8,412,554
Individual annuities	(9,443,987)	15,290,414	6,854,430
Supplementary contracts	<u>(179,533)</u>	<u>(80,838)</u>	<u>160,672</u>
Total ordinary	<u>\$11,187,733</u>	<u>\$17,791,610</u>	<u>\$15,427,656</u>
Group annuities	<u>\$ 6,563,047</u>	<u>\$31,155,287</u>	<u>\$16,044,059</u>
Accident and health – other	<u>\$ 2,590,433</u>	<u>\$ (910,409)</u>	<u>\$ 967,118</u>
All other lines	<u>\$ 1,572,212</u>	<u>\$ 9,149</u>	<u>\$ (784,962)</u>
Total	<u>\$21,913,425</u>	<u>\$48,045,637</u>	<u>\$31,653,870</u>

The decline in operating income for the ordinary life line between 1999 and 2000 was primarily due to lower investment income, lower net benefits (change in reserves, death benefits, surrender benefits), partially offset by higher federal income taxes. The change between 2000 and 2001 is primarily related to a decrease in federal income taxes.

The increase in operating income related to the ordinary individual annuity line between 1999 and 2000 is a result of an increase in the net investment income allocated to this line of business and decreased commissions and expense allowances on reinsurance assumed. Also during 2000, the Company experienced an improvement in the product margin that did not continue in 2001. The decrease in the net gain in 2001 was also related to an increased commission expense that resulted from an increase in production as well as increases in guaranteed minimum death benefit reserve requirements and a decrease in net investment income allocated to individual annuities.

The significant increase in operating income on the group annuity line of business between 1999 and 2000 is primarily due to an increase in the amount of net investment income allocated to this line. The increase was partially offset by a decrease in the product margin of \$2.5 million (resulting from an increase in production in 2000 as compared to 1999) and an

increase of \$2.4 million in general expenses. Lastly, a non-recurring large income tax benefit in 2000 related to net operation loss carrybacks had a positive effect on net operating income. The fluctuation in operating income before taxes between 2000 and 2001 is attributable to a \$1.3 million decrease in the product margin resulting from CRVM adjustments and a \$1.9 million increase in general expenses and taxes, licenses and fees. The increase in general expenses is due to a change in the allocation process associated with the expenses.

The fluctuations in net operating income on the accident and health line during the examination period were a result of reinsurance and a change in net investment income methodology. In 1999, net investment income was allocated to this line; in 2000, no investment income was allocated.

With respect to all other lines (corporate overhead), the fluctuation between 1999 and 2000 is again related to the change in net investment income allocation methodology and general expenses. No investment income was allocated to this line of business in 2000. In 2001, the decrease in this line is primarily attributable to the realized capital losses incurred in 2000 and 2001.

Section 91.4(c)(2) of Department Regulation No. 33 states, in part:

“Net investment income . . . shall be distributed to major annual statement lines of business either:

- (i) in proportion to the total mean policy reserves and liabilities of each of such major annual statement lines of business or
- (ii) in proportion to the total mean funds of each of such major annual statement lines of business. . . .”

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

“ . . . If the company’s method includes deviations from the foregoing rules, or contemplates the use of a method other than the investment year method . . . such deviations or use require the approval of the superintendent as being equitable and as being necessary for reasons of feasibility before the method can be adopted.”

The prior report on examination contained a violation of Sections 91.4 and 91.5 of Department Regulation No. 33 for failure to use one of the prescribed methods for allocating net investment income to major annual statement lines of business. In 1998, the Company filed with the Department a request for approval of the use of a segmentation method to allocate net

investment income to major annual statement lines of business. The Company continued to use the segmentation method through 2000. The Department disapproved the Company's proposed segmentation method of allocating net investment income on September 13, 2000. No subsequent filings were made. Net investment income was distributed to major annual statement lines of business based upon minimum surplus for 2000 and 2001, which is not one of the methods permitted by Department Regulation No. 33. For the years under examination, the Company did not use one of the methods described in Section 91.4(c)(2) of Department Regulation No. 33.

The Company violated Sections 91.4(c)(2) and 91.5(b) of Department Regulation No. 33 by failing to allocate net investment income to annual statement lines of business in accordance with the requirements of Department Regulation No. 33. This is a repeat violation from the prior report on examination.

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

“ . . . (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 . . .
 - (c) annual statement lines of business,
 - (d) companies, and
 - (e) a recapitulation and reconciliation of items . . . (c) and (d) with the insurer's books of account and annual statement.

(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 . . .

(5) 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, in part:

“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. . . .”

Based upon the information provided by the Company, it appears that general expenses and taxes, licenses, and fees were allocated between legal entities (affiliates) on the basis of general indexes (such as in-force/account values, sales volume, number of policies or contracts, and premium). In addition, the information provided to the examiner indicated that some costs were allocated based upon underlying cost allocation studies at the direct servicing unit level within the parent's life and retirement profit centers. However, the Company could not provide time study documentation related to past or current periods. The evidence that was provided to support the Company's allocation of expenses failed to indicate that costs were allocated by means other than general indexes.

The Company's records were not classified and indexed in such a manner to permit ready identification between the items allocated and the basis upon which they were allocated. In addition, the Company's records did not contain documentation to show that the incidence of cost is closely related to such general indexes, or that there was no more appropriate basis of measurement than the general indexes used for the allocation of expenses.

The Company violated Section 91.4(a)(3) of Department Regulation No. 33 by not maintaining its records in a manner that permits ready identification with respect to the allocation of expenses.

The Company violated Section 91.4(f)(5) of Department Regulation No. 33 by failing to provide documentation that clearly supports the Company's method of distributing expenses to the annual statement lines of business.

5. FINANCIAL STATEMENTS

The following statements show the assets, liabilities, capital, surplus and other funds as of December 31, 2001, as contained in the Company's 2001 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, 2001 filed annual statement.

A. ASSETS, LIABILITIES, CAPITAL, SURPLUS AND OTHER FUNDS AS OF DECEMBER 31, 2001

Admitted Assets

Bonds	\$1,600,918,845
Mortgage loans:	
First liens	153,875,235
Policy loans	175,000,777
Cash and short term investments	15,624,411
Other invested assets	303,089
Reinsurance ceded:	
Amounts recoverable from reinsurers	612,649
Commissions and expense allowances due	14,228
Experience rating and other refunds due	200,000
Electronic data processing equipment and software	1,803
Life insurance premiums and annuity considerations deferred and uncollected on in force business	7,002,374
Investment income due and accrued	31,819,761
Receivable from parent, subsidiaries and affiliates	338,231
Other receivables related to investments	1,381,106
Accounts receivable	239,301
Funds withheld by ceding company	2,696
Company owned policies	100
From Separate Accounts statement	<u>357,144,866</u>
 Total admitted assets	 <u>\$2,344,479,471</u>

Liabilities, Capital, Surplus and Other Funds

Aggregate reserve for life policies and contracts	\$1,730,528,169
Liability for deposit-type contracts	27,735,148
Policy and contract claims - Life	(3,448,637)
Provision for policyholders' dividends and coupons payable in following calendar year - estimated amounts:	
Dividends apportioned for payment	5,506,100
Premiums and annuity considerations for life and accident and health policies and contracts received in advance	81,208
Policy and contract liabilities:	
Other amounts payable on reinsurance assumed	244,814
Commissions to agents due or accrued	273,441
Commissions and expense allowances payable on reinsurance assumed	510,671
General expenses due or accrued	3,841,869
Transfers to Separate Accounts due or accrued	(15,141,300)
Taxes, licenses and fees due or accrued	92,276
Federal and foreign income taxes	776,880
Unearned investment income	7,360
Amounts withheld or retained by company as agent or trustee	14,134,907
Amounts held for agents' account	74,343
Remittances and items not allocated	12,002,038
Miscellaneous liabilities:	
Asset valuation reserve	6,769,086
Reinsurance in unauthorized companies	409,008
Payable to parent, subsidiaries and affiliates	5,963,245
Payable for securities	7,105,112
From Separate Accounts statement	<u>356,402,814</u>
 Total liabilities	 <u>\$2,153,868,554</u>
 Common capital stock	 \$ 2,000,000
Gross paid in and contributed surplus	384,128,481
Unassigned funds (surplus)	<u>(195,517,564)</u>
 Total capital, surplus and other funds	 <u>\$ 190,610,917</u>
 Total liabilities, capital, surplus and other funds	 <u>\$2,344,479,471</u>

B. CONDENSED SUMMARY OF OPERATIONS

	<u>1999</u>	<u>2000</u>	<u>2001</u>
Premiums and considerations	\$172,708,594	\$244,426,295	\$248,709,601
Investment income	133,138,775	132,129,632	133,791,797
Net gain from operations from Separate Accounts	0	0	(20,488)
Commissions and reserve adjustments on reinsurance ceded	(6,091,226)	3,037,942	991,573
Miscellaneous income	<u>13,558,465</u>	<u>10,261,322</u>	<u>11,534,277</u>
Total income	<u>\$313,314,608</u>	<u>\$389,855,191</u>	<u>\$395,006,760</u>
Benefit payments	\$202,637,687	\$302,446,179	\$246,396,124
Increase in reserves	5,347,471	(40,881,219)	(18,034,448)
Commissions	17,665,458	13,942,948	16,111,383
General expenses and taxes	32,790,971	34,324,038	38,908,112
Increase in loading on deferred and uncollected premium	(562,653)	283,368	(99,241)
Net transfers to (from) Separate Accounts	28,255,807	25,113,242	74,089,722
Miscellaneous deductions	<u>68,746</u>	<u>3,903</u>	<u>0</u>
Total deductions	<u>\$286,203,489</u>	<u>\$335,232,456</u>	<u>\$357,371,650</u>
Net gain (loss)	\$ 27,111,120	\$ 54,622,732	\$ 37,635,107
Dividends	5,624,728	5,784,286	5,568,553
Federal and foreign income taxes incurred	<u>(427,032)</u>	<u>792,834</u>	<u>412,686</u>
Net gain (loss) from operations before net realized capital gains	\$ 21,913,425	\$ 48,045,616	\$ 31,653,868
Net realized capital gains (losses)	<u>(2,012,332)</u>	<u>(2,233,251)</u>	<u>(12,211,520)</u>
Net income	<u>\$ 19,901,093</u>	<u>\$ 45,812,362</u>	<u>\$ 19,442,349</u>

C. CAPITAL AND SURPLUS ACCOUNT

	<u>1999</u>	<u>2000</u>	<u>2001</u>
Capital and surplus, December 31, prior year	\$ <u>111,719,278</u>	\$ <u>132,393,566</u>	\$ <u>168,619,159</u>
Net income	\$ 19,901,093	\$ 45,812,362	\$ 19,442,349
Change in net unrealized capital gains (losses)	(939,080)	(215,965)	(627,640)
Change in non-admitted assets and related items	187,322	(5,544,963)	1,543,809
Change in liability for reinsurance in unauthorized companies	(605,340)	822,580	55,812
Change in reserve valuation basis	0	(1,773,399)	0
Change in asset valuation reserve	(2,509,909)	(2,515,605)	3,535,657
Surplus (contributed to) withdrawn from Separate Accounts during the period	0	0	(397,488)
Other changes in surplus in Separate Accounts statement	0	0	378,743
Cumulative effect of changes in accounting principles	0	0	(1,426,797)
Surplus adjustments:			
Change in surplus as a result of reinsurance	4,640,203	(2,640,922)	(512,689)
Adjustment to Separate Account reserve	0	(236,941)	0
Adjustment to prior year accident and health reserve	<u>0</u>	<u>2,518,446</u>	<u>0</u>
Net change in capital and surplus	\$ <u>20,674,288</u>	\$ <u>36,225,593</u>	\$ <u>21,991,757</u>
Capital and surplus, December 31, current year	\$ <u>132,393,566</u>	\$ <u>168,619,159</u>	\$ <u>190,610,916</u>

6. INTERNAL AUDIT

Internal audit is an integral part of corporate governance that also includes the audit committee, the board of directors, senior management and the external auditors. In particular, internal auditors and audit committees are mutually supportive. Consideration of the work of internal auditors is essential for the 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. In the case of the Company, duties normally delegated to the audit committee are the fiduciary responsibility of the Independent Director Committee (which is comprised of the Company's unaffiliated directors).

In response to the examination planning questionnaire, the Company indicated that the internal audit staff of LNC also performed audits of the Company's operations.

It was not evident from a review of the board and independent committee minutes for the examination period that the independent committee of the board was involved in determining the scope or reviewing results of internal audits performed on the Company or on those affiliates that perform services related to New York insurance operations on behalf of the Company. A review of the audit summaries provided did not indicate to what extent, if at all, the Company's activities were included in the affiliate audits.

The examiner recommends that the Company enhance the scope of the audits and the reporting provided to management and the independent directors committee to more fully incorporate the Company into the ongoing assessments of its risk management processes and the accompanying system of internal control.

7. REMITTANCES AND ITEMS NOT ALLOCATED

The Company reported a liability for “Remittances and Items Not Allocated” of \$12,002,038, as of December 31, 2001. A review of “Remittances and Items Not Allocated” revealed that several of the account balances that comprise this liability remained unchanged throughout the examination period.

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 on a timely and regular basis.

8. 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(p) of Department Regulation No. 34-A states, in part:

“In all advertisements made by an insurer, or on its behalf, the name of the insurer shall be clearly identified, together with the name of the city, town or village in which it has its home office in the United States. . . .”

Section 219.5(a) of Department Regulation No. 34-A states, in part:

“Each insurer shall maintain at its home office a complete file containing a specimen copy of every printed, published or prepared advertisement hereafter disseminated in this state, with a notation indicating the manner and extent of distribution and the form number of any policy advertised. . . .”

A review of a sample of 144 advertisements revealed that in 18 of the cases (12.50%), the Company failed to maintain a final specimen copy of the advertisement. In 25 of the cases (17.4%), the Company's advertisements failed to include the name of the city, town or village in which it has its home office. In 42 of the cases (29.16%), the examiner was not able to determine the manner and extent of distribution of the advertisement.

The Company violated Section 219.4(p) of Department Regulation No. 34-A by failing to include the name of the city, town or village in which it has its home office on its advertisements.

The Company violated Section 219.5(a) of Department Regulation No. 34-A by failing to maintain a specimen copy of every advertisement printed, published, or prepared and disseminated in this state and by failing to maintain in this state information regarding the manner and extent of distribution of its advertisements.

B. Underwriting and Policy Forms

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

Section 2611(b) of the New York Insurance Law states, in part:

“Written informed consent to an HIV related test shall consist of a written authorization that is dated and includes at least the following . . .

(3) a statement that a positive test result is an indication that the individual may develop AIDS and may wish to consider further independent testing . . .

(5) the department of health’s statewide toll-free telephone number that may be called for futher (sic) information about AIDS, the meaning of HIV related test results, and the availability and location of HIV related counseling services . . .

1. The examiner’s review of the Company’s HIV test consent forms XL-HIVNY(08/00)-A and XL-HIVNY(08)-B revealed that the forms do not contain a statement that a positive test result is an indication that the individual may develop AIDS and may wish to consider further independent testing. In addition, the Company’s HIV test consent form FOD Form B10368NY 10/98 (New York), also used during the examination period, does not contain a statement notifying the individual that he/she may consider further independent testing.

The Company violated Section 2611(b)(3) of the New York Insurance Law by failing to include required statements on its HIV consent forms.

2. The examiner’s review of the Company’s HIV test consent form FOD Form B10368NY 10/98 (New York) revealed that the form does not contain the Department of Health’s statewide toll-free telephone number.

The Company violated Section 2611(b)(5) of the New York Insurance Law by failing to include the Department of Health’s statewide toll-free telephone number on its HIV-related testing authorization forms.

Section 243.2(b) of Department Regulation No. 152 states, in part:

“Except as otherwise required by law or regulation, an insurer shall maintain . . .
(iv) Other information necessary for reconstructing the solicitation, rating, and underwriting of the contract or policy. . . .”

The Company stated the following with regard to their procedures during the examination period in cases where HIV related testing occurred:

“The Company does provide all individuals with XL-HIVNY(08/00)-A and XL-HIV(08/00)-B when a chemical profile is required. It is a pre-issue requirement, although copies are not always maintained in the files.”

The examiner recommends that the Company maintain copies of the consent forms in the policy files in order to demonstrate compliance with Section 2611(b)(4) of the New York Insurance Law and Section 243.2(b) of Department Regulation No. 152.

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.

Section 3214(c) of the New York Insurance Law states, in part:

“If no action has been commenced, interest upon the principal sum paid to the beneficiary or policyholder shall be computed daily . . . from the date of the death of an insured or annuitant in connection with a death claim on such a policy of life insurance or contract of annuity . . . to the date of payment and shall be added to and be a part of the total sum paid.”

A review of the eight individual annuity death claims paid during the examination period indicated that interest on proceeds was paid up to the date that the claim was processed and not to the date of payment. The number of days between the date of processing and the date of payment was from one to 12 days.

The Company violated Section 3214(c) of the New York Insurance Law by failing to pay interest upon the principal sum paid from the date of death of the insured or annuitant to the date of payment.

D. Response to Supplement No. 1 to Department Circular Letter No. 19 (2000)

Supplement No. 1 to Circular Letter No. 19 (2000) (the “Supplement”), issued by the Department on June 22, 2000, notified all licensed life insurers that the Department was investigating allegations of race-based underwriting of life insurance by its licensees. The Supplement directed, pursuant to Section 308 of the New York Insurance Law, each domestic and foreign life insurer to review its past and present underwriting practices regarding race-based underwriting and to report its findings to the Department, no later than August 15, 2000.

Pursuant to Section 308 of the New York Insurance Law, the Company submitted in a timely manner a report of the findings of its review of past and present underwriting practices regarding race-based underwriting made in accordance with the requirements of the Supplement.

In summary, the Company’s findings were that the marketing and sale of life insurance using underwriting and/or pricing factors which are based on race, color, creed, or national origin have not been employed by the Company at all during its existence. The Company also indicated that this is also true for business acquired by the Company from other entities (CIGNA and ALIAC). The Company commenced business on October 1, 1996. The underwriting rules, guidelines, rate cards, and business practices used during its brief existence were reviewed to determine whether the Company had exercised any race-based underwriting practices since its inception. ALIAC did not issue any life insurance policies in New York until 1981. ALIAC’s review did not identify any evidence of discriminatory practices. CIGNA’s investigation also did not reveal any evidence or examples of race-based underwriting of life insurance.

An analysis of the Company’s response to the Supplement and other factors indicated that the Company’s review of its past and present underwriting practices complied with the requirements of the Supplement.

9. PRIOR REPORT SUMMARY AND CONCLUSIONS

Following are the violations 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>The Company violated Section 1505(d)(2) of the New York Insurance Law by failing to notify the Superintendent of its intention to enter into reinsurance contracts with affiliates.</p> <p>During the examination period, the only new reinsurance transactions entered into with an affiliate concerned amendments made to the Company's pooling arrangement. The pooling arrangement is entered into with seven reinsurers, one of which is the Company's parent. The Company requested and received Department approval for the proposed amendments.</p>
B	<p>The Company violated Sections 91.4(c)(2) and (3) and 91.5(b) of Department Regulation No. 33 by failing to allocate net investment income to annual statement lines of business in accordance with the requirements of this regulation.</p> <p>The Company failed to take corrective action. Violations of Department Regulation No. 33 appear in this report on examination.</p>

10. SUMMARY AND CONCLUSIONS

Following are the violations and recommendations contained in this report:

<u>Item</u>	<u>Description</u>	<u>Page No(s).</u>
A	The examiner recommends that the Company review its service agreements and revise them accordingly to accurately reflect how services are billed, how settlements are made, and what affiliate is actually providing services.	6 – 9
B	The Company violated Section 1505(d)(3) of the New York Insurance Law by failing to reimburse an affiliate for services provided on a regular and systematic basis, contrary to the filed administrative service agreement.	6 – 9
C	The Company violated Section 1505(d)(3) of the New York Insurance Law by failing to bill or charge for services provided to an affiliate on a regular and systematic basis, contrary to the filed administrative service agreement.	6 – 9
D	The Company violated Section 4228(e)(3)(C) of the New York Insurance Law by paying compensation in the form of training allowance subsidies to certain agents, who did not qualify for such additional compensation.	12
E	The examiner recommends that the Company maintain policy level detail for its assumed and ceded reinsurance business that can be reconciled to the amounts reported in its filed annual statement.	13
F	The Company violated Sections 91.4(c)(2) and 91.5(b) of Department Regulation No. 33 by failing to allocate net investment income to annual statement lines of business in accordance with the requirements of Department Regulation No. 33.	16 – 17
G	The Company violated Section 91.4(a)(3) of Department Regulation No. 33 by not maintaining its records in a manner that permits ready identification with respect to the allocation of expenses.	17 – 18

<u>Item</u>	<u>Description</u>	<u>Page No(s).</u>
H	The Company violated Section 91.4(f)(5) of Department Regulation No. 33 by failing to provide documentation that clearly supports the Company's method of distributing expenses to the annual statement lines of business.	17 – 18
I	The examiner recommends that the Company enhance the scope of the audits and the reporting provided to management and the independent directors committee to more fully incorporate the Company into the ongoing assessments of its risk management processes and the accompanying system of internal control.	23
J	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 on a timely and regular basis.	24
K	The Company violated Section 219.4(p) of Department Regulation No. 34-A by failing to include the name, city, town or village in which it has its home office on its advertisements.	25
L	The Company violated Section 219.5(a) of Department Regulation No. 34-A by failing to maintain a specimen copy of every advertisement printed, published, or prepared and disseminated in this state and by failing to maintain in this state information regarding the manner and extent of distribution of its advertisements.	25
M	The Company violated Section 2611(b)(3) of the New York Insurance Law by failing to include required statements on its HIV consent forms.	26
N	The Company violated Section 2611(b)(5) of the New York Insurance Law by failing to include the department of health's statewide toll-free telephone number on its HIV-related testing authorization forms.	26
O	The examiner recommends that the Company maintain copies of consent forms in the policy files in order to demonstrate compliance with Section 2611(b)(4) of the New York Insurance Law and Section 243.2(b) of Department Regulation No. 152.	27
P	The Company violated Section 3214(c) of the New York Insurance Law by failing to pay interest upon the principal sum paid from the date of death of the insured or annuitant to the date of payment.	27

APPOINTMENT NO. 21932

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, GREGORY V. SERIO, Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:

EDEN SUNDERMAN

as a proper person to examine into the affairs of the

LINCOLN LIFE & ANNUITY COMPANY OF NEW YORK

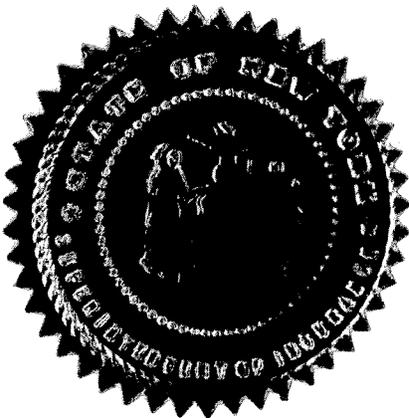
and to make a report to me in writing of the condition of the said

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 27th day of August, 2002



GREGORY V. SERIO

Superintendent of Insurance

[Handwritten Signature]
Superintendent