

STATE OF NEW YORK INSURANCE DEPARTMENT  
REPORT ON EXAMINATION  
OF THE  
NATIONAL INTEGRITY LIFE INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2001

DATE OF REPORT:

JULY 19, 2002

EXAMINER:

PHARES CATON

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

July 19, 2002

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

Sir:

In accordance with instructions contained in Appointment No. 21827, dated January 25, 2002 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

In December 1999, the ARM Financial Group, the Company's former ultimate parent, signed a definitive agreement whereby Western and Southern Life Insurance Company ("WSLIC") would acquire Integrity Life Insurance Company ("Integrity") and the Company. The purchase was completed in March 2000. The Company is now part of the Western Southern Financial Group, Inc. ("WSFG"). (See item 3A of this report)

The Company violated Section 325(a) of the New York Insurance Law when the Company did not keep and maintain its books of account at its principal office in this state. (See item 7 of this report)

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)

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. (See item 4 of this report)

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. (See item 6A 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
- 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 name, Merchants 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 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, the ARM Financial Group acquired the Company and its immediate parent, Integrity. In 1993, paid in and contributed surplus increased from \$57,978,351 to \$59,244,533 as a result of a contribution to surplus of \$1,266,182.

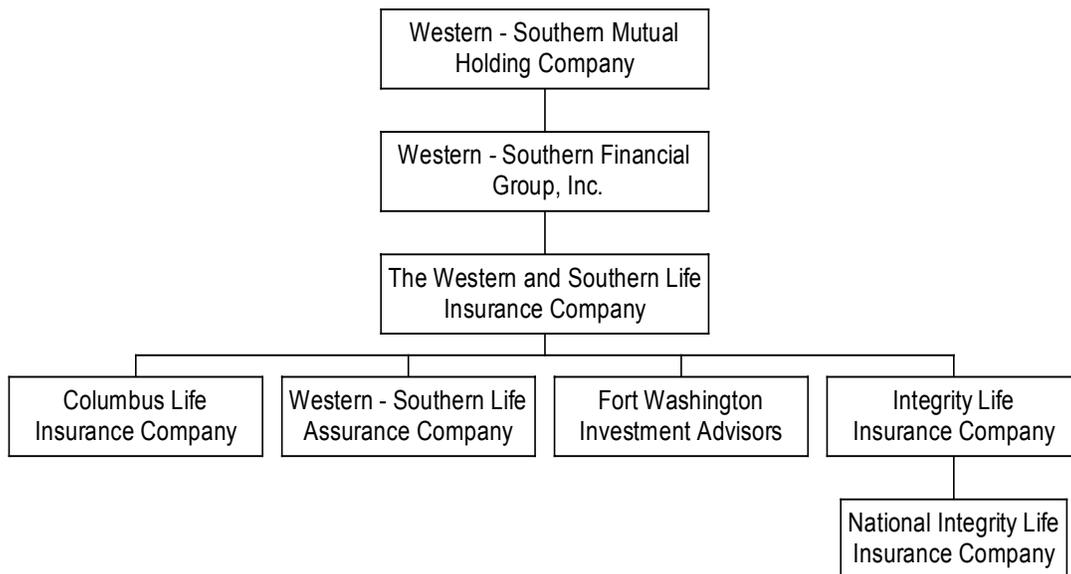
In December 1999, the ARM Financial Group signed a definitive agreement whereby WSLIC would acquire Integrity and the Company. The purchase was completed in March 2000. The Company is now part of WSFG, a financial services holding company.

During 2000, the Company received a surplus contribution of \$41,824,626 from Integrity. This increased the Company’s gross paid in and contributed surplus to \$101,069,159. Capital and paid in and contributed surplus were \$2,000,000 and \$101,069,159, respectively, as of December 31, 2001.

## 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 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, 2001 follows:



The Company had four service agreements in effect with affiliates as of December 31, 2001. The agreements are summarized below.

An Administrative Service Agreement with Integrity, whereby the Company is provided with accounting, tax and auditing, underwriting, claims, marketing and product development services.

An Investment Service Agreement with Fort Washington Investment Advisors (“FWIA”), whereby the Company is provided with investment advisory services based on the Company’s guidelines.

An Administrative Service Agreement with WSLIC, whereby the Company is provided with accounting, tax and auditing services, administrative support services, payroll functions and personnel functions.

The above three agreements were in effect in March 2000 at the time of the change in ownership of the Company from ARM Financial Group to WSLIC. As a consequence of the ownership change the providers of services also changed, while the services provided remained the same. The Company submitted these agreements to the Department in April 2001. The agreements were approved in May 2002.

A Short Term Trading Agreement with Western-Southern Life Assurance Company (“WSLAC”) was submitted to the Department. The agreement provides for the Company to obtain short-term money management services from WSLAC. The Department is reviewing the terms of the agreement.

The Company has a tax allocation agreement dated January 1, 1990 to file a consolidated federal tax return with Integrity.

### 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 in February of each year. As of December 31, 2001, the board of directors consisted of 11 members. Meetings of the board are held annually.

The 11 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>
John F. Barrett Cincinnati, OH	President and Chief Executive Officer Western and Southern Life Insurance Company	2000
Dennis L. Carr Louisville, KY	Vice President and Chief Actuary National Integrity Life Insurance Company	1998
Daniel J. Downing Warwick, NY	Vice President National Integrity Life Insurance Company	1998
Eric C. Fast* Rye, NY	President and Chief Operating Officer Crane Company	2000

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>	<u>Year First Elected</u>
Dale P. Hennie Cincinnati, OH	Senior Vice President Western and Southern Life Insurance Company	2000
John R. Lindholm Louisville, KY	President National Integrity Life Insurance Company	1997
Cameron F. MacRae* New York, NY	Attorney LeBoeuf, Lamb, Greene and MacRae	2000
Newton P. S. Merrill* New York, NY	Senior 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	Chairman of the Board Western - Southern Financial Group, Inc. National Integrity Life Insurance Company	2000
Donald J. Wuebbling Cincinnati, OH	Senior Vice President, General Counsel Western and Southern Life Insurance Company	2000

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

Section 1201(a)(5)(B)(v) of the New York Insurance Law states, in part:

“ . . . the number of directors shall not be less than thirteen . . . ”

Article 5 of the Company’s charter states, in part:

“The Board of Directors shall consist of not less than 13 (except for vacancies temporarily unfilled) . . . ”

After the sale of the Company to WSFG, the stockholders elected a new board of directors. However, the stockholders only elected eleven directors to sit on the board.

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.

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>
John R. Lindholm	President
Don W. Cummings	Chief Financial Officer, Vice President
Dennis L. Carr	Chief Actuary, Vice President
Edward J. Babbitt	Secretary
David L. Anders	Vice President
William H. Guth	Vice President
Edward J. Haines	Vice President
Kevin L. Howard*	Vice President
James G. Kaiser	Vice President
Jill R. Keinsley	Vice President
William F. Ledwin	Vice President
Ken Arthur Palmer	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, Vermont and the District of Columbia. In 2001, 93.4% of annuity considerations and deposit type funds were received from 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.

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

#### E. Reinsurance

As of December 31, 2001, the Company had reinsurance treaties in effect with seven companies, of which six 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, 2001, was \$78,741,997, which represents 22% of the total face amount of life insurance in force.

The total face amount of life insurance assumed as of December 31, 2001, was \$274,919,585. The Company assumed the business from two unaffiliated companies.

The Company entered into a surplus relief reinsurance agreement covering annuities with RGA Reinsurance Company in 1999, which provided the Company with \$4.4 million in surplus relief. That contract was terminated in 2000 at which point the Company reported a \$2.1 million reserve adjustment on reinsurance ceded.

#### 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>\$1,259,683,459</u>	<u>\$1,558,665,411</u>	<u>\$298,981,952</u>
Liabilities	<u>\$1,200,180,184</u>	<u>\$1,499,757,886</u>	<u>\$299,577,702</u>
Common capital stock	\$ 2,000,000	\$ 2,000,000	\$ 0
Gross paid in and contributed surplus	59,244,533	101,069,159	41,824,626
Aggregate write-ins for special surplus funds	750,000	0	(750,000)
Unassigned funds (surplus)	<u>(2,491,258)</u>	<u>(44,161,634)</u>	<u>(41,670,376)</u>
Total capital and surplus	<u>\$ 59,503,275</u>	<u>\$ 58,907,525</u>	<u>\$ (595,750)</u>
Total liabilities, capital and surplus	<u>\$1,259,683,459</u>	<u>\$1,558,665,411</u>	<u>\$298,981,952</u>

The majority (68%) of the Company's admitted assets, as of December 31, 2001, was derived from Separate Accounts.

The Company's invested assets as of December 31, 2001, exclusive of Separate Accounts, were mainly comprised of bonds (74%), cash and short-term investments (14%) and policy loans (7%).

The majority (93%) of the Company's bond portfolio, as of December 31, 2001, was comprised of investment grade obligations.

The Company's unassigned funds (surplus) decreased by \$41,670,376 during the period under examination. This was mainly due to the permanent write down of certain impaired assets (\$33 million) and changes required by codification (\$8.67 million).

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	\$ 1,219,373	\$(4,287,187)	\$ (428,250)
Individual annuities	10,263,442	(5,152,268)	8,023,029
Supplementary contracts	<u>570,298</u>	<u>222,121</u>	<u>(444,366)</u>
Total	<u>\$12,053,113</u>	<u>\$(9,217,334)</u>	<u>\$7,150,413</u>

In 1999, the Company reported a gain in the individual annuities line of business that was mainly due to commissions received in connection with the surplus relief reinsurance agreement with RGA Reinsurance Company.

In 2000, the Company changed its method of allocation of net investment income and improperly included the Separate Accounts reserves as part of the basis for the allocation of net investment income for 2000 and 2001. For 2000, the change in the method caused: a reduction in the net investment income attributable to the ordinary life line of business by approximately \$3.9 million; a reduction in the net income attributable to supplementary contracts by \$.4 million; and increased the net income attributable to the annuity line by \$4.5 million. Also, in 2000, the Company returned commissions to RGA Reinsurance Company upon termination of the surplus relief reinsurance agreement.

The gain in the annuity line of business for 2001 was overstated due to the misallocation of net investment income by approximately \$5 million. Also, the Company collected \$334 million in considerations in the annuity line of business compared to \$186 million in 2000.

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

“Net investment income, after adjustment, if any . . . 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. . . .”

The Company incorrectly included the Separate Account reserves as part of the basis for the allocation of net investment income. The Company should have only included the reserves from the general account as a basis for allocation of net investment income.

The Company violated Section 91.4(c)(2) of Department Regulation No. 33 by incorrectly including the Separate Account reserves as part of the basis for the allocation and distribution of net investment income to 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. . . .”

During the examination period, the Company used a method based on percentage of assets to allocate expenses among major annual statement lines of business, which is a general index. Section 91.4(f)(5) of Department Regulation No. 33 specifies that general indexes shall not be used as a basis to allocate costs unless there is no more appropriate basis for measurement.

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.

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.”

The Company also used an allocation method based on percentage of assets to allocate expenses between companies. As noted above, this method does not comply with Section 91.4(f)(5) of Department Regulation No. 33.

The examiner recommends that the Company adopt a method of allocation that is in line with the requirements of Department Regulation No. 33

## 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	\$ 366,494,630
Stocks:	
Preferred stocks	9,739,864
Mortgage loans:	
First liens	1,341,750
Policy loans	32,636,024
Cash and short term investments	69,339,850
Other invested assets	3,755,402
Receivable for securities	4,551,102
Federal income tax recoverable	2,169,943
Investment income due and accrued	6,909,099
Miscellaneous assets	107,437
From Separate Accounts statement	<u>1,061,620,310</u>
 Total admitted assets	 <u>\$1,558,665,411</u>

Liabilities, Capital, Surplus and Other Funds

Aggregate reserve for life policies and contracts	\$ 448,953,160
Liability for deposit-type contracts	5,567,249
Policy and contract claims:	
Life	50,000
General expenses due or accrued	2,787
Transfers to Separate Accounts due or accrued	(9,689,463)
Taxes, licenses and fees due or accrued	624,834
Federal income taxes due or accrued	1,238,039
Amounts withheld or retained by company as agent or trustee	48,071
Remittances and items not allocated	659,280
Miscellaneous liabilities:	
Asset valuation reserve	5,101,899
Payable to parent, subsidiaries and affiliates	2,417,916
Payable for securities	7,796,390
Payable to reinsurer	366,657
Miscellaneous liabilities	757
From Separate Accounts statement	<u>1,036,620,310</u>
 Total liabilities	 <u>\$1,499,757,886</u>
 Common capital stock	 \$ 2,000,000
Gross paid in and contributed surplus	101,069,159
Unassigned funds (surplus)	<u>(44,161,634)</u>
 Total capital, surplus and other funds	 <u>\$ 58,907,525</u>
 Total liabilities, capital, surplus and other funds	 <u>\$1,558,665,411</u>

B. CONDENSED SUMMARY OF OPERATIONS

	<u>1999</u>	<u>2000</u>	<u>2001</u>
Premiums and considerations	\$151,305,340	\$194,053,816	\$343,128,882
Investment income	40,146,250	33,245,966	30,553,793
Net gain from operations from Separate Accounts	14,800,000	0	0
Commissions and reserve adjustments on reinsurance ceded	83,164,272	(628,841)	0
Miscellaneous income	<u>11,957,388</u>	<u>10,596,868</u>	<u>9,175,864</u>
Total income	<u>\$301,373,250</u>	<u>\$237,267,809</u>	<u>\$382,858,539</u>
Benefit payments	\$244,637,054	\$187,255,615	\$157,849,528
Increase in reserves	22,960,692	(61,693,056)	54,007,940
Commissions	17,790,876	14,993,350	20,292,052
General expenses and taxes	8,188,423	7,579,812	9,186,695
Net transfers to (from) Separate Accounts	212,744	98,224,066	137,222,711
Miscellaneous deductions	<u>643,032</u>	<u>1,127,794</u>	<u>48,238</u>
Total deductions	<u>\$294,432,821</u>	<u>\$247,487,581</u>	<u>\$378,607,164</u>
Net gain (loss)	\$ 6,940,429	\$ (10,219,771)	\$ 4,251,376
Federal and foreign income taxes incurred	<u>(5,112,684)</u>	<u>(1,002,436)</u>	<u>(2,899,038)</u>
Net gain (loss) from operations before net realized capital gains	\$ 12,053,113	\$ (9,217,335)	\$ 7,150,414
Net realized capital gains (losses)	<u>(1,254,868)</u>	<u>0</u>	<u>159,987</u>
Net income	<u>\$ 10,798,245</u>	<u>\$ (9,217,335)</u>	<u>\$ 7,310,401</u>

C. CAPITAL AND SURPLUS ACCOUNT

	<u>1999</u>	<u>2000</u>	<u>2001</u>
Capital and surplus, December 31, prior year	\$ <u>59,503,275</u>	\$ <u>55,179,041</u>	\$ <u>72,422,484</u>
Net income	\$ 10,798,245	\$ (9,217,335)	\$ 7,310,401
Change in net unrealized capital gains (losses)	0	0	(8,770)
Change in non-admitted assets and related items	0	(13,480,981)	132,226
Change in reserve valuation basis	0	(923,214)	0
Change in asset valuation reserve	(322,479)	(1,455,653)	(120,207)
Surplus (contributed to) withdrawn from Separate Accounts during period	0	(36,813,818)	1,000,381
Other changes in surplus in Separate Accounts statement	(14,800,000)	37,309,818	11,238,619
Cumulative effect of changes in accounting principles	0	0	(33,067,609)
Surplus adjustments: Paid in	<u>0</u>	<u>41,824,626</u>	<u>0</u>
Net change in capital and surplus	\$ <u>4,324,234</u>	\$ <u>17,234,444</u>	\$ <u>(13,514,959)</u>
Capital and surplus, December 31, current year	\$ <u>55,179,041</u>	\$ <u>72,422,485</u>	\$ <u>58,907,525</u>

## 6. MARKET CONDUCT ACTIVITIES

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

### A. Advertising and Sales Activities

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

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

“Each insurer shall maintain at its home office a complete file . . . with a notation indicating the manner and extent of distribution and the form number of any policy advertised. . . .”

The Company maintains a form indicating the manner and extent of distribution of its advertisements; however the form is not maintained in the advertising file at the Company's home office.

The examiner recommends that the Company maintain the form indicating the manner and extent of distribution of its advertisements in its advertising file at its home office.

Section 219.4(e) of Department Regulation No. 34-A states, in part:

“The words *free, no cost, without cost, no additional cost, at no extra cost, without additional cost*, or words of similar import, may not be used with respect to any benefit or service being made available with the policy. . . .”

The Company stated in two of its advertisements for variable annuities that a death benefit is also included with the policy at no additional cost.

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.

### B. Underwriting and Policy Forms

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

The Company did not maintain documentation indicating the policy forms issued for new contracts.

The examiner recommends that the Company maintain, as part of the underwriting file, a record of the policy forms issued for each new contract.

### 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.

### 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.

The Company reported that it performed a number of tests to determine whether or not it had any business on the books for which race was used as a basis for premium rates, underwriting ratings, dividends, etc. In summary, the Company's findings were that, to the best of their knowledge, the Company has not historically engaged in marketing or selling business based on race-based underwriting. This includes policies issued directly by the Company and business previously acquired as a result of assumption, merger, acquisition, consolidation or purchase.

An analysis of the Company's response was not possible because the Company stated that no workpapers were produced.

## 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 . . .”

The Company did not maintain its books of account at its principal office in this state. The records that were not maintained at the Company's home office included the general ledger, investment ledger, journals, cash books, subsidiary ledgers and all other worksheets supporting annual, quarterly and other statements and reports filed with or submitted to supervisory and regulatory authorities. The Company has access at the principal office to all financial transactions, through the use of a computer and a connection to Integrity. However, no records are maintained in a durable medium in the New York office.

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.

## 8. RESERVES

The Department's review of the reserves reported in the 2001 filed annual statement revealed the following issues.

The Guaranteed Minimum Death Benefit ("GMDB") reserves for variable annuity contracts were not calculated in accordance with Department Regulation No. 151 - Valuation of Annuity, Single Premium Life, Guaranteed Interest Contracts and Other Deposit Reserves. However, the Department determined that the Company's reserves were sufficient.

The Company has agreed to calculate the GMBD reserves in accordance with Department Regulation No. 151 for the September 2003 quarterly statement.

The Market Value Adjusted Annuities ("MVAA") represent a significant block of the Company's business. The cash flow testing of the MVAA was not modeled with adequate sophistication. The Company has made some improvements in the analysis.

The examiner recommends that the Company continue to improve its MVAA modeling in cash flow testing. The Company has agreed to implement a more sophisticated competitor rate formula in 2003.

## 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 91.5(b) of the Department Regulation No. 33 by adopting a method of distributing net investment income to major annual statement lines of business, which deviates from the rules prescribed in Section 91.5(a) of Department Regulation No. 33, without obtaining the Superintendent's prior approval.</p> <p>The Company now uses the mean reserve method of income allocation. The Company, however, incorrectly applied the allocation method. A violation of Department Regulation No. 33 appears in the current report on examination.</p>
B	<p>The Company violated Section 1313(d) of the New York Insurance Law by distributing an advertisement that stated that the Company's New Momentum policies are guaranteed wholly by another insurer.</p> <p>The Company no longer distributes this piece of advertising.</p>
C	<p>The Company violated Section 2122(a)(2) of the New York Insurance Law by distributing advertisements that called attention to an unauthorized insurer in seven advertisements.</p> <p>The Company no longer calls attention to an unauthorized insurer.</p>
D	<p>The Company violated Section 219.4(o) of Department Regulation No. 34-A by distributing an advertisement that created the impression that its financial condition is superior to what can be found elsewhere in the industry, without providing sufficient proof.</p> <p>The Company no longer distributes this piece of advertising.</p>
E	<p>The Company violated Section 219.4(p) of Department Regulation No. 34-A by distributing an advertisement that failed to identify the city, town or village of the Company's home office.</p> <p>All of the Company's advertisements identify the city town or village of its home office.</p>

<u>Item</u>	<u>Description</u>
F	<p>The Company violated Section 219.5(a) of Department Regulation No. 34-A when it failed to maintain a complete advertisement file by not including a notation indicating the extent of distribution of its advertisements.</p> <p>The Company maintains a form indicating the manner and extent of distribution of its advertisements; however the form is not maintained in the advertising file at the Company's home office. This report contains a recommendation that the Company maintain the form indicating the manner and extent of distribution of its advertisements in its advertising file at its home office.</p>

10. SUMMARY AND CONCLUSIONS

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

<u>Item</u>	<u>Description</u>	<u>Page No(s).</u>
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.	7
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.	11 – 12
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.	12
D	The examiner recommends that the Company adopt a method of allocation that is in line with the requirements of Department Regulation No. 33.	12
E	The examiner recommends that the Company maintain the form indicating the manner and extent of distribution of its advertisements in its advertising file at its home office.	17
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.	17
G	The examiner commented that an 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.	18 – 19
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.	19
I	The Company has agreed to calculate the GMBD reserves in accordance with Department Regulation No. 151 for the September 2003 quarterly statement. The Company has also agreed to implement a more sophisticated competitor rate formula for its MVAA in 2003.	20



APPOINTMENT NO. 21827

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:

**PHARES CATON**

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 25th day of January, 2002



**GREGORY V. SERIO**

Superintendent of Insurance

*[Handwritten Signature]*  
Superintendent