

STATE OF NEW YORK INSURANCE DEPARTMENT  
REPORT ON EXAMINATION  
OF THE  
SENTRY LIFE INSURANCE COMPANY OF NEW YORK  
AS OF  
DECEMBER 31, 2000

DATE OF REPORT:

MARCH 5, 2002

EXAMINER:

EDEN M. SUNDERMAN

## TABLE OF CONTENTS

<u>ITEM</u>	<u>PAGE NO.</u>
1. Executive summary	2
2. Scope of examination	3
3. Description of Company	4
A. History	4
B. Holding company	4
C. Management	6
D. Territory and plan of operation	8
E. Reinsurance	9
4. Significant operating results	10
5. Financial statements	14
A. Assets, liabilities, capital, surplus and other funds	14
B. Condensed summary of operations	16
C. Capital and surplus account	17
6. Internal audit	18
7. Separate Accounts	19
8. Market conduct activities	21
A. Advertising and sales activities	21
B. Underwriting and policy forms	24
C. Treatment of policyholders	25
D. Response to Supplement No. 1 to Department Circular Letter No. 19 (2000)	26
9. Prior report summary and conclusions	28
10. Summary and conclusions	29



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

March 5, 2002

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

Sir:

In accordance with instructions contained in Appointment No. 21775, dated September 10, 2001 and annexed hereto, an examination has been made into the condition and affairs of Sentry Life Insurance Company of New York, hereinafter referred to as "the Company" or "SLONY," at its home office located at 251 Salina Meadows Parkway, Suite 255, Syracuse, New York 13212.

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 Company violated Section 4240(e) of the New York Insurance Law by not having certain Separate Account assets totaling \$5,520,245 held in the name of the Company. The assets are held in the name of an affiliate. (See items 5 and 7 of this report)

The Company violated Section 243.2(b)(7) of Department Regulation No. 152 by failing to maintain the financial records required by the Regulation. (See item 7 of this report)

The Company violated Section 2122(a)(2) of the New York Insurance Law, Section 219.4(p) of Department Regulation No. 34-A and Section 215.13(a) of Department Regulation No. 34 by calling attention to an unauthorized affiliated insurer in a manner that may have the tendency to mislead as to the true identity of the insurer in a number of its advertisements, including internet sites. (See item 8A of this report)

The Company violated Section 3211(g) of the New York Insurance Law by failing to notify insureds at least annually of their right to request an updated policy illustration. This is a repeat violation from the prior report on examination. (See item 8C of this report)

The Company violated Section 4228(f) of the New York Insurance Law by failing to make an initial filing with respect to its existing compensation plans. (See item 3D of this report)

The Company violated Section 3204 of the New York Insurance Law by adding the automatic policy loan provision without prior written consent from the applicant/policyowner in cases where the automatic policy loan provision was not affirmatively selected. (See item 8C of this report)

The Company violated Section 91.4(f) of Department Regulation No. 33 by failing to provide documentation that supports the Company's method of distributing expenses to the annual statement lines of business. (See item 4 of this report)

## 2. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 1997. This examination covers the period from January 1, 1998 through December 31, 2000. As necessary, the examiner reviewed transactions occurring subsequent to December 31, 2000 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, 2000 to determine whether the Company's 2000 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 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

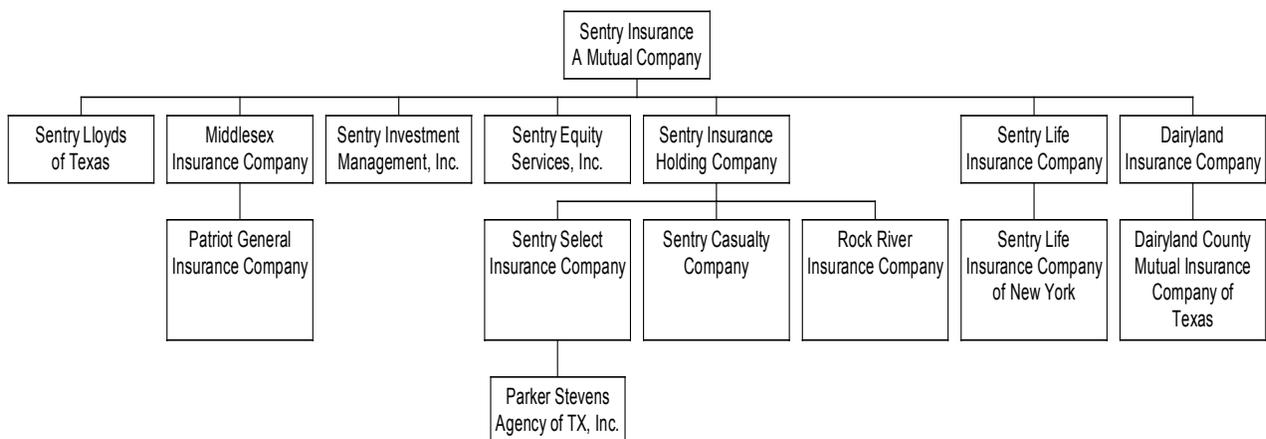
#### A. History

The Company was incorporated as a stock life insurance company under the laws of New York on May 23, 1966, was licensed on January 13, 1967 and commenced business on January 27, 1967. Initial resources of \$2,000,000, consisting of common capital stock of \$500,000 and paid in and contributed surplus of \$1,500,000, were provided through the sale of 50,000 shares of common stock (with a par value of \$10 each) for \$40 per share. In 1976, an additional \$2,000,000 was contributed to surplus. In 1977, capital was increased to \$1,000,000 as a result of an additional capital contribution of \$500,000, at the same time that the par value of the common stock was increased from \$10 to \$20 per share. All of the Company's common shares are outstanding.

#### B. Holding Company

The Company is a wholly owned subsidiary of Sentry Life Insurance Company ("SLIC"), a Wisconsin life insurance company. SLIC is in turn a wholly owned subsidiary of the Company's ultimate parent, Sentry Insurance A Mutual Company ("SIAMCO"), a property and casualty insurance company licensed in New York.

An organization chart reflecting the relationship between the Company and significant entities in its holding company system as of December 31, 2000 follows:



The Company had five service agreements in effect as of December 31, 2000.

1. An administrative service agreement with SIAMCO dated January 1, 1982 whereby SIAMCO provides: product administration; customer record keeping; beneficiary designation and changes; policy and certificate issuance; underwriting; data processing; legal; claims; accounting; actuarial; advertising; and sales services to the Company. Reimbursement is to be made within 30 days of receipt of supporting documentation and verification of charges.
2. An administrative service agreement with SLIC, effective January 1, 1984, whereby SLIC agrees to provide SLONY with all administrative services required to issue and service variable annuity contracts. Such services include establishing and maintaining policy records, shareholder accounting, processing applications and subsequent contract changes, and reporting to contract holders. In addition, SLIC agrees to provide SLONY with all actuarial, accounting, and legal services required to administer the variable annuity contracts and the Separate Account (Sentry Variable Account I). Charges are to be submitted each month with appropriate supporting documentation. Reimbursement is to be made to SLIC within 30 days of receipt.
3. An investment management agreement with Sentry Investment Management, Inc., effective January 1, 1972 (“SIMI”) whereby SIMI manages the Company’s investment portfolio. A quarterly fee is based upon a percentage of the market value of the managed assets. The fee for each quarter is payable to SIAMCO within 15 days of receipt of supporting documentation and verification of charges.
4. A broker/dealer administrative service agreement with Sentry Equity Services, Inc. (“SESI”), effective August 1, 1984, whereby SESI agrees to maintain certain accounting books and records, send required transaction confirmations and pay any commissions which may be due on the sale of variable annuity contracts. Expenses are to be paid immediately upon receipt of notice.
5. A principal underwriters agreement with SESI on behalf of Sentry Variable Account I (the “Variable Account”), effective May 1, 1984, whereby SESI agrees to provide sales services for variable annuity contracts issued through the Variable Account.

Compensation is based upon a percentage (4.7%) of all annuity purchase payments accepted by SLONY.

In addition, the Company has a consolidated federal tax allocation agreement in effect with its ultimate parent, SIAMCO.

The Company also has a joint investment agreement by and among SIAMCO and certain of its subsidiaries and affiliates dated October 1, 1996 under the name "Sentry Liquid Asset Partnership" ("SLAP") for the purpose of investing and reinvesting its funds in short-term obligations of banks, corporations, and the federal government.

All billings and payments for all services rendered by affiliates under the aforementioned service agreements are processed monthly through SIAMCO, which acts like a clearinghouse and performs such processing on behalf of itself and all its affiliates. In addition, all settlements for services rendered are ultimately made by SIAMCO through the SLAP account of the appropriate affiliate instead of being settled in cash. Not all of the aforementioned service agreements reflect the monthly processing through SIAMCO or the settlements through the SLAP account.

The examiner recommends that the Company review its service agreements and revise them accordingly to reflect how services are billed and how settlements are made.

### C. Management

The Company's by-laws provide that the board of directors shall be comprised of nine directors; provided the number of directors will increase to not less than 13 within one year following the end of the calendar year in which admitted assets of the Company exceed five hundred million dollars. Directors are elected for a period of three years at the annual meeting of the stockholders held in May of each year. As of December 31, 2000, the board of directors consisted of nine members. Meetings of the board are held quarterly.

The nine board members and their principal business affiliation, as of December 31, 2000, were as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>	<u>Year First Elected</u>
Steven R. Boehike Stevens Point, WI	Retired Vice President Sentry Insurance A Mutual Company	1992
Dennis R. Cabrey* East Syracuse, NY	Dentist Self-employed	1998
Larry R. Leatherman* Fayetteville, NY	Director of Operations Bristol Meyers Squibb Company	1995
William J. Lohr Stevens Point, WI	Treasurer Sentry Life Insurance Company of New York	1999
John D. Marshall* Liverpool, NY	Accountant Testone, Marshall & Discenza, LLP	1997
William M. O'Reilly Stevens Point, WI	Secretary Sentry Life Insurance Company of New York	1997
Harold A. Rice Stevens Point, WI	President Sentry Life Insurance Company of New York	1994
Dale R. Schuh Stevens Point, WI	President & Chief Executive Officer Sentry Insurance A Mutual Company	1990
Wallace D. Taylor Stevens Point, WI	Vice President Sentry Insurance A Mutual Company	1999

\* 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, 2000:

<u>Name</u>	<u>Title</u>
Harold A. Rice*	President
William M. O'Reilly	Secretary
William J. Lohr	Treasurer
David A. Derksen	Actuary

\* 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 three states, namely Minnesota, New York, and North Dakota. In 2000, all accident and health premiums, annuity considerations, and deposit type funds and 87.15% of life insurance premiums were received from New York. Policies were written on a non-participating basis through year-end 1996. In March of 1996, the Company received a permit pursuant to Section 4231(f) of the New York Insurance Law to issue participating whole life policies and contracts in New York and began issuing such policies in 1997. The Company currently writes both participating and non-participating whole life policies.

During the examination period, the Company primarily sold individual life, group life and health and group pension products. The individual life insurance line includes whole life and term life insurance products. The group life and health line consists mainly of term life, dental, and indemnity insurance products. The group pension products consist of Separate Account variable annuity contracts used for the purpose of funding pension and/or profit sharing plans. The plan participants have 17 different investment options varying from a money market account to aggressive stock funds, as well as a guaranteed fund. The Company also sells individual variable annuities. In 2000, the Company introduced new individual variable annuity investment options (portfolios) in an effort to enhance the product and generate new business.

Effective January 1999, the Company discontinued writing universal life insurance. In addition, the Company exited the small group medical insurance market, non-renewing its remaining business starting with anniversary dates on or after January 1, 2000.

The Company's agency operations are conducted through a combination of salaried sales representatives and an independent general agency system of approximately 233 representatives.

Section 4228(f)(1) of the New York Insurance Law states, in part:

“Filing requirements for agent compensation plans are as follows:

(A) A company shall make annual information filings with respect to any newly-introduced plans or changes under which the company makes payments to agents if such plans are commission plans for which the commission percentages are, in all policy or contract years, no greater than the commission percentages set forth in paragraphs one, two, three and four of subsection (d) of this section, expense allowance plans other than those meeting the definition of a compensation arrangement, plans subject to the provisions of paragraph one of subsection (e) of this section under which compensation is not in excess of two percent of the fund annually in any of the first four policy or contract years, or plans subject to the provisions of paragraph four of subsection (e) of this section. These filings shall consist of a summary of information in enough detail to generally describe the filing content, and shall be made not later than the last day of February next following the year in which such plans were placed in use or changed. The first such filing shall be due not later than the last day of February following the end of the year which includes the effective date of this section. . . .”

The Company did not submit filings for agent compensation plans in use prior to the January 1, 1998 revision of Section 4228 of the New York Insurance Law.

The Company violated Section 4228(f)(1)(A) of the New York Insurance Law by not filing with the Department agent compensation plans in use prior to January 1, 1998 and which continued to be used after that date.

#### E. Reinsurance

As of December 31, 2000, the Company had reinsurance treaties in effect with ten companies, of which nine were authorized or accredited. The Company's ordinary life and accident and health policies are ceded on a coinsurance and yearly renewable term basis. Reinsurance is provided on an automatic and facultative basis.

The maximum retention limit for individual life contracts is \$50,000. The total face amount of life insurance ceded as of December 31, 2000, was \$44,622,391, which represents 6% of the total face amount of life insurance in force. Of the total face amount of life insurance reinsured, 85.0% is with SLIC an unauthorized affiliate. Reserve credit taken for reinsurance ceded to unauthorized companies, totaling \$63,686 was supported by funds withheld.

#### 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>1997</u>	December 31, <u>2000</u>	Increase (Decrease)
Admitted assets	<u>\$38,955,255</u>	<u>\$39,393,882</u>	<u>\$438,627</u>
Liabilities	<u>\$29,137,607</u>	<u>\$29,301,094</u>	<u>\$163,487</u>
Common capital stock	\$ 1,000,000	\$ 1,000,000	\$ 0
Gross paid in and contributed surplus	3,500,000	3,500,000	0
Special reserve	50,391	3,030	(47,361)
Group contingency reserve	89,993	66,417	(23,576)
Unassigned funds (surplus)	<u>5,177,263</u>	<u>5,523,342</u>	<u>346,079</u>
Total capital and surplus	<u>\$ 9,817,647</u>	<u>\$10,092,789</u>	<u>\$275,142</u>
Total liabilities, capital and surplus	<u>\$38,955,255</u>	<u>\$39,393,882</u>	<u>\$438,627</u>

The Company's invested assets as of December 31, 2000, exclusive of Separate Accounts, were mainly comprised of bonds (91.1%) and policy loans (5.4%).

The majority (96.4%) of the Company's bond portfolio, as of December 31, 2000, 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>1998</u>	<u>1999</u>	<u>2000</u>
Ordinary:			
Life insurance	\$597,250	\$ 574,599	\$ 957,276
Individual annuities	(12,170)	(17,749)	(37,863)
Supplementary contracts	<u>9,167</u>	<u>8,393</u>	<u>9,153</u>
Total ordinary	<u>\$594,247</u>	<u>\$ 565,243</u>	<u>\$ 928,566</u>
Group:			
Life	\$103,125	\$ 169,904	\$96,327
Annuities	<u>41,910</u>	<u>70,657</u>	<u>(57,071)</u>
Total group	<u>\$145,035</u>	<u>\$ 240,561</u>	<u>\$ 39,256</u>
Accident and health:			
Group	\$105,463	\$ 391,221	\$ 292,134
Other	<u>(54,684)</u>	<u>(23,626)</u>	<u>(32,239)</u>
Total accident and health	<u>\$ 50,779</u>	<u>\$ 367,595</u>	<u>\$ 259,895</u>
Total	<u>\$790,061</u>	<u>\$1,173,399</u>	<u>\$1,227,717</u>

The individual annuity line of business experienced consistent losses during the examination period. This is a small block of business that has experienced no growth during the examination period. The individual annuity line of business includes Separate Accounts. In an effort to increase sales of the Sentry Variable Annuity I product, the Company introduced several new portfolio investment options during the examination period.

The consistent losses on the other accident and health line are related to a closed block of non-cancelable disability income policies. It is not likely that this block of business will be profitable in the future.

In 2000, commission expenses on a large group annuity pension case sold during that year caused a loss on that line of business.

The positive results in the group accident and health line of business as compared to prior periods is mostly due to a 1997 rate increase associated with the Company's small group medical

business as well as the Company's decision not to write "health benefit plans" in the "small employer" market. As rate increases continued, very little small group medical business was written in 1998 and most of the existing policyholders dropped their coverage. The remaining community rated business "ran off" the books in 2001.

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

"(1) It is the responsibility of each life insurer to use only such methods of allocation as will produce a suitable and equitable distribution of income and expenses by lines of business. Unless impractical or unfeasible, an insurer may use only such methods of allocation in its distribution of income and expenses within annual statement lines of business as are compatible with the methods it uses for distribution between annual statement lines of business.

(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 (a), (b), (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 . . .

(4) Bases of allocation shall be reviewed periodically to ascertain the suitability for continued use.

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

"(1) In distributing costs to lines of business, each company shall employ those principles and methods that will reasonably reflect the actual incidence of cost by line of business. The relative time spent, the extent of usage and the varying volume of work performed for each line of business shall be considered in distributing cost to major annual statement lines of business and, to the extent practicable, to secondary annual statement lines of business . . .

(5) 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. . . ."

On October 30, 2001, the examiner requested documentation to support the method(s) employed to allocate expenses to annual statement lines of business during the examination period. The supporting documentation for allocation of expenses to annual statement lines of business was received January 29, 2002.

Based upon a review of the material provided, the examiner was unable to determine if the methods used by the Company to allocate expenses produced a suitable and equitable distribution of expenses by line of business.

In addition, some expenses were allocated to lines of business on the basis of weighted premium volume. The Company failed to provide documentation to clearly demonstrate that the allocation of certain expenses to lines of business on the basis of weighted premium reasonably reflects the actual incidence of cost by line of business.

The Company violated Section 91.4(a)(3) of Department Regulation No. 33 by not maintaining its records related to the allocation of expenses in a manner that is classified and indexed in such form as to permit ready identification and is readily accessible for examination.

The Company violated Section 91.4(f) of Department Regulation No. 33 by failing to provide documentation that 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, 2000, as contained in the Company's 2000 filed annual statement, a condensed summary of operations and a reconciliation of the capital and surplus account for each of the years under review.

### A. ASSETS, LIABILITIES, CAPITAL, SURPLUS AND OTHER FUNDS AS OF DECEMBER 31, 2000

#### Admitted Assets

Bonds	\$28,860,074
Policy loans	1,696,641
Cash and short term investments	743,024
Receivable for securities	80,828
Funds in transit	309,444
Life insurance premiums and annuity considerations deferred and uncollected on in force business	194,913
Accident and health premiums due and unpaid	3,282
Investment income due and accrued	564,721
Receivable from parent, subsidiaries and affiliates	785
Accounts receivable – other	524
From Separate Accounts statement	<u>6,939,646</u>
 Total admitted assets	 <u>\$39,393,882</u>

Liabilities, Capital, Surplus and Other Funds

Aggregate reserve for life policies and contracts	\$16,733,524
Aggregate reserve for accident and health policies	420,027
Supplementary contracts without life contingencies	2,392
Policy and contract claims:	
Life	230,157
Accident and health	311,711
Liability for premium and other deposit funds – Other contract deposit funds	3,538,069
Policy and contract liabilities:	
Surrender values on canceled policies	40
Interest maintenance reserve	52,343
Commissions to agents due or accrued	9,445
General expenses due or accrued	42,529
Transfers to Separate Accounts due or accrued	(10,489)
Taxes, licenses and fees due or accrued	67,412
Federal income taxes due or accrued	453,007
Cost of collection on premiums and annuity considerations deferred and uncollected in excess of total loading thereon	5,736
Amounts withheld or retained by company as agent or trustee	1,340
Remittances and items not allocated	54,135
Miscellaneous liabilities:	
Funds held under reinsurance treaties with unauthorized reinsurers	100,000
Payable to parent, subsidiaries and affiliates	282,186
Payable for securities	57,732
Escheat	10,099
Group conversion costs	45
Interest on policy funds	99
Accounts payable other	(91)
From Separate Accounts statement	<u>6,939,646</u>
Total liabilities	<u>\$29,301,094</u>
Common capital stock	\$ 1,000,000
Special reserve	3,030
Gross paid in and contributed surplus	3,500,000
Group contingency reserve	66,417
Unassigned funds (surplus)	<u>5,523,342</u>
Total capital, surplus and other funds	<u>\$10,092,789</u>
Total liabilities, capital, surplus and other funds	<u>\$39,393,882</u>

B. CONDENSED SUMMARY OF OPERATIONS

	<u>1998</u>	<u>1999</u>	<u>2000</u>
Premiums and considerations	\$ 7,151,769	\$ 6,164,053	\$ 8,317,066
Investment income	2,627,438	2,436,476	2,369,666
Commissions and reserve adjustments on reinsurance ceded	16,835	20,064	10,351
Miscellaneous income	<u>131,580</u>	<u>248,576</u>	<u>127,192</u>
Total income	<u>\$ 9,927,622</u>	<u>\$ 8,869,169</u>	<u>\$10,824,275</u>
Benefit payments	\$ 8,381,224	\$ 7,825,152	\$ 4,908,254
Increase in reserves	(1,492,952)	(1,857,526)	2,631
Commissions	345,193	272,488	214,172
General expenses and taxes	1,207,120	960,417	713,969
Increase in loading and cost of collection	(2,724)	3,636	(17,194)
Net transfers to (from) Separate Accounts	226,511	(139,454)	3,200,214
Miscellaneous deductions	<u>40,452</u>	<u>0</u>	<u>0</u>
Total deductions	<u>\$ 8,704,824</u>	<u>\$ 7,064,713</u>	<u>\$ 9,022,046</u>
Net gain (loss)	\$ 1,222,798	\$ 1,804,456	\$ 1,802,229
Federal income taxes	<u>432,736</u>	<u>631,054</u>	<u>574,515</u>
Net gain (loss) from operations before net realized capital gains	\$ 790,062	\$ 1,173,402	\$ 1,227,714
Net realized capital gains (losses)	<u>(130,524)</u>	<u>(154,268)</u>	<u>(162,917)</u>
Net income	<u>\$ 659,538</u>	<u>\$ 1,019,134</u>	<u>\$ 1,064,797</u>

C. CAPITAL AND SURPLUS ACCOUNT

	<u>1998</u>	<u>1999</u>	<u>2000</u>
Capital and surplus, December 31, prior year	\$ <u>9,817,647</u>	\$ <u>9,532,940</u>	\$ <u>9,869,912</u>
Net income	\$ 659,538	\$1,019,134	\$ 1,064,797
Change in nonadmitted assets and related items	71	0	0
Change in liability for reinsurance in unauthorized companies	(57,264)	57,264	0
Change in asset valuation reserve	(7,052)	110,574	38,078
Dividends to stockholders	<u>(880,000)</u>	<u>(850,000)</u>	<u>(880,000)</u>
Net change in capital and surplus	\$ <u>(284,707)</u>	\$ <u>336,972</u>	\$ <u>222,875</u>
Capital and surplus, December 31, current year	\$ <u>9,532,940</u>	\$ <u>9,869,912</u>	\$ <u>10,092,787</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 SLONY, duties normally delegated to the audit committee are the fiduciary responsibility of the finance 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 SIAMCO also performed audits of the Company's operations. In response to the examiner's request for all internal audits that pertained to the Company, the examiner was provided with two internal audits performed on SIAMCO during the examination period covering: 1) the Group Pensions Department and 2) the Policy Benefits Department. Subsequently, the examiner became aware of other internal audits performed on SIAMCO and requested such from the Company.

A review of the audit reports did not indicate whether or not any SLONY activity was included in the audits. In addition, a review of the finance committee minutes indicated that no internal audit reports were provided to the committee.

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

## 7. SEPARATE ACCOUNTS

Section 4240(e) of the New York Insurance Law states, in part:

“No authorized insurer shall make any . . . agreement in this state providing for the allocation of amounts to a separate account until such insurer has filed with the superintendent a statement as to its methods of operation of such separate account and the superintendent has approved such statement. Subject to the approval of the superintendent, any such statement may apply to one or more groups of separate accounts classified by investment policy . . . .”

The Company’s approved plan(s) of operation does not provide for assets of the Separate Account to be held other than in the name of the Company. The documentation obtained from the investment advisors revealed that for 18 of the 23 mutual fund investments reported on Schedule D of the Company’s Separate Account statement, Sentry Life Insurance Company was the named owner of the account, not Sentry Life Insurance Company of New York. The total amount reported on Schedule D of the Separate Account statement for the 18 mutual funds in question totaled \$5,520,245.

The Company violated Section 4240(e) of the New York Insurance by investing the assets of its Separate Accounts contrary to the provisions of its approved plan(s) of operation. The examiner recommends that the Company take steps necessary to accurately reflect the proper ownership of the Separate Account assets.

With respect to records required for examination purposes, Section 243.2(b) of Department Regulation No. 152 states, in part:

“Except as otherwise required by law or regulation, an insurer shall maintain . . . .  
(7) A financial record necessary to verify the financial condition of an insurer, including ledgers, journals, trial balances . . . and source documents, for six calendar years from its creation or until after the filing of the report on examination in which the record was subject to review, whichever is longer. . . .”

In an undated memo received by the examiner on February 19, 2002, the Company summarized the accounting procedures related to the Separate Account individual and group pension variable annuity operations as follows:

“ . . . The Slony separate accounts invest in various mutual funds managed by Vanguard (PN), T Rowe Price (PN and VA) and Janus (PN and VA).

Daily, Slony policyholders make deposits, transfers, and withdrawals from the two product administration systems. The net \$ to each separate account portfolio (10 VA [individual variable annuity investment options] and 17 PN [group pension annuity investment options]) are traded with the advisors. A wire transfer is sent to (from) the investment advisor each day to settle the trades. The administration systems ledger interface posts (monthly) the transfers to clearance accounts (unique for each product and advisor) and the wire transfer clears the balance.

The daily wire combines both Slic and Slony trades in one wire. An intercompany payable/receivable is set up between Slic and Slony to reimburse the creditor for the appropriate funds. As Slony trades are typically not material, a month end wire transfer is done for both VA [individual variable annuity] and PN [group pension variable annuity], to settle the receivable/payable. If a significant receivable/payable develops due to a large trade, a mid month wire transfer is processed.

These cash transfers are accomplished through the Slap balances of the affected companies.

Slony maintains separate accounts at T Rowe Price and Janus related to the [individual] variable account product. These are separate and distinct from the Slic accounts. The daily trade activity is kept separate as well. . . .

For the 17 group annuity separate accounts, Slic and Slony maintain a joint account at each Investment Advisor. Both Slic and Slony have a separate administrative agreement with each Investment Advisor. Trade and balance information (ownership) between Slic and Slony is maintained in the administration system and the pricing system . . . ”

The Company's Separate Account funds are being commingled with the Separate Account funds of their affiliate, SLIC. The books, accounts, records, and underlying transactions related to the Company's Separate Account business are not being maintained in a manner so as to disclose clearly and accurately the nature and details of such transactions. Based upon the information made available to the examiner in the home office, the examiner was unable to verify participant level accounting transaction detail, such as deposit and withdrawal transactions.

The Company violated Section 243.2(b)(7) of Department Regulation No. 152 by failing to maintain the financial records required by the Regulation.

## 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.

1. Section 219.5(a) of Department Regulation No. 34-A, applicable to life insurance, 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. In order to be complete, the file must contain all advertisements whether used by the company, its agents or solicitors or other persons. . . .”

- Section 215.17(a) of Department Regulation No. 34, applicable to accident and health insurance, states, in part:

“Each insurer shall maintain at its home office or principal office a complete file containing every printed, published or prepared advertisement of its individual policies and typical printed, published or prepared advertisements of its blanket, franchise and group policies hereafter disseminated in this or any other State whether or not licensed in such other State, with a notation attached to each such advertisement which shall indicate the manner and extent of distribution and the form number of any policy advertised. Such file shall be subject to regular and periodical inspection by the department. . . .”

A review of the Company's advertising files for the years under examination revealed that the files did not contain a notation regarding the manner and extent of distribution as required by the Regulations.

The Company violated Section 219.5(a) of Department Regulation No. 34-A and Section 215.17(a) of Department Regulation No. 34 by failing to indicate the manner and extent of distribution for each policy advertised during the examination period.

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

“An advertisement shall not create the impression that the insurer, its financial condition or status, the payment of its claims, or the merits, desirability or appropriateness of its policy forms or kinds of plans of insurance, are superior to what can be found elsewhere in the industry, unless such can be proven.”

The Company made statements in a number of advertisements comparing itself and its products and services to what may be found elsewhere in the industry. The Company was unable to provide documentation to substantiate such claims in its advertisements.

The Company violated Section 219.4(o) of Department Regulation No. 34-A for comparing itself and its products and services to what may be found elsewhere in the industry without being able to substantiate such statements.

3. Section 219.4(p) of Department Regulation No. 34-A, applicable to life insurance and annuities, states, in part:

“An advertisement shall prominently describe the type of policy advertised. If a specific policy or policy series is being advertised, the form or series number or other appropriate description shall be shown. . . .”

Section 215.13(a) of Department Regulation No. 34, applicable to accident and health insurance, states, in part:

“The name of the actual insurer and the form number or numbers advertised shall be identified and made clear in all of its advertisements. . . .”

A review of the Company’s advertising files revealed that a number of advertisements failed to include the policy form or series number.

The Company violated Section 219.4(p) of Department Regulation No. 34-A and Section 215.13(a) of Department Regulation No. 34 by failing to include the policy form or series number of the policy being advertised for a number of its advertisements.

4. Section 2122(a)(2) of the New York Insurance Law states:

“No insurance agent, insurance broker or other person, shall, by any advertisement or public announcement in this state, call attention to any unauthorized insurer or insurers.”

Section 219.4(p) of Department Regulation No. 34-A, applicable to life insurance and annuities, states, in part:

“In all advertisements made by an insurer, or on its behalf, the name of the insurer shall be clearly identified . . . . An advertisement shall not use a trade name, an insurance group designation, name of the parent company or affiliate of the insurer, name of a particular division of the insurer, service mark, slogan, symbol, or other device or reference if such use would have the tendency to mislead or deceive as to the true identity of the insurer, or create the impression that someone other than the insurer would have any responsibility for the financial obligation under a policy.”

Section 215.13(a) of Department Regulation No. 34, applicable to accident and health insurance, states, in part:

“The name of the actual insurer and the form number or numbers advertised shall be identified and made clear in all of its advertisements. An advertisement shall not use a trade name, any insurance group designation, name of the parent company of the insurer, name of a particular division of the insurer, service mark, slogan, symbol or other device which without disclosing the name of the actual insurer would have the capacity and tendency to mislead or deceive as to the true identity of the insurer...”

Department Circular Letter No. 5 (2001) advises, in part:

“ . . . if the insurance products or services are not being offered by a New York authorized insurer, the advertisements or the web sites upon which the advertisements appear must contain a clear and conspicuous disclaimer indicating that the advertised products or services are not available in New York State, and such products and services cannot, in fact, be made available in New York. For example, a disclaimer stating ‘not available in all states’ would be sufficient. . . . ”

A number of Company advertisements contained the name of an unauthorized affiliated insurer. Additionally, a number of these advertisements included the mailing address of the unauthorized affiliate which may have the tendency to mislead or deceive as to the true identity of the insurer, or create the impression that an affiliate may have responsibility for the financial obligation under a Sentry Life Insurance Company of New York policy or contract.

A number of Company advertisements refer New York residents to Sentry internet sites [www.sentryins.com](http://www.sentryins.com) and [www.sentry.com](http://www.sentry.com). The [www.sentry.com](http://www.sentry.com) internet site does not contain clear and conspicuous disclaimers indicating that certain advertised products or services are not available in New York. In addition, [www.sentry.com](http://www.sentry.com) contains advertisements for several products and services currently sold by Sentry Life Insurance Company of New York, but such pages contain the name of an affiliate only and not the Company. The general manner in which information is presented to current and prospective policyholders on the internet site, [www.sentry.com](http://www.sentry.com), may have the tendency to mislead or confuse the reader as to the identity of the actual insurer or may create the impression that an entity other than Sentry Life Insurance Company of New York would have the responsibility for the financial obligation under policies sold in New York.

The Company violated Section 2122(a)(2) of the New York Insurance Law, Section 219.4(p) of Department Regulation No. 34-A and Section 215.13(a) of Department Regulation No. 34 by calling attention to an unauthorized insurer and by advertising in a manner that may have the tendency to mislead as to the true identity of the insurer in a number 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.

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

### C. Treatment of Policyholders

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

Section 3204 of the New York Insurance Law states, in part:

“(a)(1) Every policy of life, accident or health insurance, or contract of annuity, delivered or issued for delivery in this state, shall contain the entire contract between the parties, and nothing shall be incorporated therein by reference to any writing, unless a copy thereof is endorsed upon or attached to the policy or contract when issued . . .

(3) Such policy or contract cannot be modified, nor can any rights or requirements be waived, except in writing signed by a person specified by the insurer in such policy or contract. . . .”

A review of policyholder application files revealed that several policyholders whose premium was paid under the Automatic Premium Loan (“APL”) provision did not affirmatively select that option. Upon further review it was discovered that the Company, in situations where the policyholder did not select the APL benefit, sent the policyholder a letter that states, in part:

“As a further enhancement, Sentry has added the Automatic Premium Loan provision to your permanent life policy at no additional cost to you. This feature provides the advantage that should your premium not be paid by the end of the grace period, an automatic loan will be taken from your permanent life surrender value\*, this provision will prevent your coverage from inadvertently terminating due to the nonpayment of premium.

Since we have added the Automatic Premium Loan to your policy and if you decide against this no cost provision please sign and return this letter. We will promptly remove this from your policy.”

Unless the policyholder takes action and returns the letter indicating that they do not wish to have the APL provision, the Company automatically adds the APL provision to the policy.

The Company violated Section 3204 of the New York Insurance Law by adding the automatic policy loan provision without prior written consent from the applicant/policyowner in cases where the automatic policy loan provision was not affirmatively selected.

Section 3211(g) of the New York Insurance Law states, in part:

“In the case of life insurance policies to which this section is applicable and which contain a cash surrender value, the insurer must provide an annual notification that the policy contains a cash surrender value and that further information, including the amount thereof, is available from the insurer upon written request from the policyowner. Such notification shall include a statement that the insured has the right to request an updated policy illustration . . . ”

A review of the Company’s anniversary premium notices for traditional life products and the annual statements for universal life products that are sent to policyowners revealed that the cash value notification failed to include a statement regarding the insured’s right to request an updated policy illustration.

The Company violated Section 3211(g) of the New York Insurance Law by failing to notify insureds at least annually of their right to request an updated policy illustration. This is a repeat violation from the prior report on examination. (See item 8C of this report)

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 a report, dated October 11, 2000, 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 the Company reviewed its past and current underwriting practices, including underwriting rules, rate filings, policy form filings, commission schedules, agent contracts, and board of director minutes. Based on the review, the Company concluded that race-based underwriting is not currently taking place, nor has it taken place in the past.

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 Sections 215.17(a) and 219.5(a) of Department Regulation No. 34 and No. 34-A by failing to maintain complete advertising files for the three years under examination.</p> <p>A review of the advertising file revealed that the Company maintained a complete advertising file of all such advertisements disseminated in this State during the examination period; however, such advertising file did not contain a notation regarding the manner and extent of distribution for each advertisement as required by Sections 215.17(a) and 219.5(a) of Department Regulation No. 34 and No. 34-A, respectively.</p>
B	<p>The Company violated Section 219.4(p) of Department Regulation No. 34-A by failing to include the name of the city in which it has its home office and the policy form or series number of the policy being advertised.</p> <p>A review of Company advertisements used during the examination period indicates that the name of the city in which the Company has its home office is now printed on Company advertisements; however, the Company failed to take corrective action in response to this prior report violation with respect to including the policy form or series number on Company advertisements.</p>
C	<p>The Company violated Section 3211(g) of the New York Insurance Law by failing to notify policyowners at least annually of their right to request an updated policy illustration.</p> <p>The Company failed to take corrective action in response to this prior report violation. Therefore, the Company again violated Section 3211(g) of the New York Insurance Law.</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 examiner recommends that the Company review its service agreements and revise them accordingly to reflect how services are billed and how settlements are made.	6
B	The Company violated Section 4228(f)(1)(A) of the New York Insurance Law by failing to make an initial filing with respect to its existing compensation plans.	9
C	The Company violated Section 91.4(a)(3) of Department Regulation No. 33 by not maintaining its records related to the allocation of income and expenses in a manner that is classified and indexed in such form as to permit ready identification and is readily accessible for examination.	12 - 13
D	The Company violated Section 91.4(f) of Department Regulation No. 33 by failing to provide documentation that supports the Company's method of distributing expenses to the annual statement lines of business.	12 - 13
E	The examiner recommends that the Company establish and maintain an independent, adequately resourced, and competently staffed internal audit function to provide management and the finance committee with ongoing assessments of the Company's risk management processes and the accompanying system of internal control.	18
F	The Company violated Section 4240(e) of the New York Insurance by investing the assets of the Separate Account contrary to the provisions of its approved plan(s) of operations. The examiner recommends that the Company take steps necessary to accurately reflect the proper ownership of the Separate Account assets	19
G	The Company violated Section 243.2(b)(7) of Department Regulation No. 152 by failing to maintain the financial records required by the Regulation.	19 - 21
H	The Company violated Section 219.5(a) of Department Regulation No. 34-A and Section 215.17(a) of Department Regulation No. 34 by failing to indicate the manner and extent of distribution for each policy advertised during the examination period.	21 - 22

<u>Item</u>	<u>Description</u>	<u>Page No(s).</u>
I	The Company violated Section 219.4(o) of Department Regulation No. 34-A for comparing itself and its products and services to what may be found elsewhere in the industry without being able to substantiate such statements.	22
J	The Company violated Section 219.4(p) of Department Regulation No. 34-A and Section 215.13(a) of Department Regulation No. 34 by failing to include the policy form or series number of the policy being advertised for a number of Company advertisements.	22 - 23
K	The Company violated Section 2122(a)(2) of the New York Insurance Law, Section 219.4(p) of Department Regulation No. 34-A and Section 215.13(a) of Department Regulation No. 34 by calling attention to an unauthorized insurer and advertising in a manner that may have the tendency to mislead as to the true identity of the insurer in a number of its advertisements.	23 - 24
L	The Company violated Section 3204 of the New York Insurance Law by adding the automatic policy loan provision without prior written consent from the applicant/policyowner in cases where the automatic policy loan provision was not affirmatively selected.	25
M	The Company violated Section 3211(g) of the New York Insurance Law by failing to notify insureds at least annually of their right to request an updated policy illustration.	26



APPOINTMENT NO. 21775

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

**SENTRY LIFE INSURANCE 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 10th day of September, 2001



**GREGORY V. SERIO**  
Superintendent of Insurance

*G. V. Serio*  
Superintendent