

**REPORT ON EXAMINATION**  
**OF THE**  
**FIDUCIARY INSURANCE COMPANY OF AMERICA**  
**AS OF**  
**DECEMBER 31, 1999**

**DATE OF REPORT**

**JULY 5, 2001**

**EXAMINER**

**FROILAN L. ESTEBAL**

## TABLE OF CONTENTS

<u>ITEM NO.</u>	<u>PAGE NO.</u>
1. Scope of examination	2
2. Description of Company	3
A. Management	3
B. Territory and plan of operation	7
C. Holding company system	8
D. Third Party Administrator	11
E. Reinsurance	12
F. Accounts and records	12
G. Significant operating ratios	14
3. Financial statements	15
A. Balance sheet	15
B. Underwriting and investment exhibit	17
4. Unearned Premium Reserve; Accident and Health Policy Contract Claims	18
5. Market conduct activities	19
6. Compliance with prior report on examination	20
7. Summary of comments and recommendations	21



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

July 5, 2001

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

Sir:

Pursuant to the provisions of the New York Insurance Law and acting in accordance with instructions contained in Appointment Number 21523, dated April 10, 2000, annexed hereto, I have made an examination as of December 31, 1999, into the condition and affairs of Fiduciary Insurance Company of America, ("FICA"), an accident and health insurer licensed pursuant to the provisions of Article 42 of the New York Insurance Law. FICA is domiciled in the State of New York, and the examination took place at its statutory home office located at 7 Hanover Square, New York, NY 10004. The following report thereon is respectfully submitted.

Wherever the terms "the Company" or "FICA" appear herein, without qualification, they should be understood to indicate the Fiduciary Insurance Company of America. The term "Department" as used in this report refers to the New York State Insurance Department.

## 1. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 1993. This examination covers the six-year period from January 1, 1994 through December 31, 1999. Transactions subsequent to this period were reviewed where deemed appropriate.

The examination comprised a complete verification of assets and liabilities as of December 31, 1999, a review of income and disbursements to the extent deemed necessary to accomplish such analysis or verification and utilized, to the extent considered appropriate, work performed by the Company's independent certified public accountants. A review or audit was also made of the following items as called for in the Examiners' Handbook of the National Association of Insurance Commissioners:

- History of Company
- Management and control
- Corporate records
- Fidelity bonds and other insurance
- Territory and plan of operation
- Market conduct activities
- Growth of Company
- Business in force
- Loss experience
- Accounts and records

A review was also made to ascertain what action was taken by the Company with regard to comments in the prior report on examination.

This report on examination is confined to financial statements, and comments on those matters which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

## **2. DESCRIPTION OF COMPANY**

The Fiduciary Insurance Company of America was incorporated on October 24, 1977 and commenced business on January 1, 1978. The Company received its authorization from the State of New York to write accident and health insurance. During the examination period, the Company principally wrote New York statutory disability business on a direct basis, and assumed student accident and health business.

Initial resources of \$500,000 (capital of \$150,000 and paid-in surplus of \$350,000) were provided through the sale of 500 shares of common stock, for \$1,000 per share. FICA's capital consists of 500 shares of \$300 par value per share common stock of which 150 shares are voting and 350 are non-voting. No shares of capital stock have been issued since the initial offering.

The Company is a wholly-owned subsidiary of the Guardian Life Insurance Company of America ("Guardian"), which purchased FICA on September 24, 1999 for \$2,959,000. The Company is licensed in New York. It has not written any new business since the acquisition and its entire insurance business consists of renewals of existing policies. The Company also ceased assumption of student accident and health business in 1999, prior to the acquisition.

### **A. Management**

The charter and by-laws of the Company provide that the corporate powers be exercised by a board of directors through officers or committees elected or appointed by the board. The number of directors, as of the examination date, has been set at not less than thirteen or more than

seventeen directors. However, a review of the board minutes and the filed annual statement revealed that the Company's board consisted of only nine members, which is not in compliance with its by-laws, and is violative of New York Insurance Law Section 1202(a)(1) which states in part:

"...and subject to any provision of the corporate charter of a domestic insurance company, the number of directors shall be fixed by the by-laws, or if not so fixed, by action of the directors."

Further, Section 1201(a)(5)(B)(v) states in part:

"..the number of directors, or that it shall be not less than a stated minimum nor more than a stated maximum. Except as provided in section six thousand four hundred two of this chapter the number of directors shall not be less than thirteen."

It is recommended that the Company comply with the requirements of New York Insurance Law Sections 1202(a)(1) and 1201(a)(5)(B)(v) and abide by its own by-laws.

As of the examination date, the board of directors consisted of 9 members as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Armand Michael dePalo Massapequa Park, NY	Senior Vice President & Chief Actuary, The Guardian Life Insurance Company of America
Sanford Barry Herman Fairfield, CT	Vice President, Group Pricing and Standards, The Guardian Life Insurance Company of America
Peter Lounsbery Hutchings New York, NY	Executive Vice President & Chief Financial Officer, The Guardian Life Insurance Company of America
Edward Konrad Kane New York, NY	Executive Vice President, The Guardian Life Insurance Company of America

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Gary Bert Lenderink Hawthorne, NJ	Executive VP, Group Ins. & Administration, The Guardian Life Insurance Company of America
Thomas Alan McInteer Bethlehem, PA	Second Vice President, Group Life and Disability, The Guardian Life Insurance Company of America
Herschel Reich Brooklyn, NY	Vice President Group Health Care, The Guardian Life Insurance Company of America
Joseph Dudley Sargent Fairfield, CT	President & Chief Executive Officer, The Guardian Life Insurance Company of America
Jeremy Starr New York, NY	Vice President, Reinsurance, The Guardian Life Insurance Company of America

A review of its board minutes revealed that, in January 2000, the Company's board held the only meeting since FICA's acquisition in 1999. No other meetings took place during the examination period. Article II, Section 2 of the Company's by-laws states:

"Not less than four regular meetings of the Board of directors shall be held each year upon such dates as may be fixed by the Board or upon ten (10) days notice from the President or Secretary of the corporation to each director either personally or by mail or by wire."

Members of the board have a fiduciary responsibility and must evince an on-going interest in the affairs of the Company. It is essential that board members attend meetings consistently and set forth their views on relevant matters so that appropriate policy decisions may be reached by the board.

It is recommended that the board members of the Company schedule and attend meetings as required by its by-laws.

Additionally, a review of the minutes for the years covered by this examination and the subsequent year showed no indication that the board of directors were involved in the crucial decision-making process relative to the investments of the Company. This is contrary to the requirements of Section 1411(a) of the New York Insurance Law, which states:

“No domestic insurer shall make any loan or investment unless authorized or approved by its board of directors or a committee thereof responsible for supervising or making such investment or loan. The committee’s minutes shall be recorded and a report submitted to the board of directors at its next meeting.”

It is recommended that the board of directors be fully apprised of the Company’s investments and financial position on a regular basis by management as required by Section 1411(a) of the New York Insurance Law

Furthermore, Sections 3 and 4 of Article II of the Company’s by-laws specify the formulation and composition of a formal Executive and Finance Committees. A review of the board of directors’ minutes revealed that there were no such committees formulated since the acquisition of the Company by Guardian. The Company stated that they had not formed either committee as of the date of the examination.

It is recommended that the Company comply with the requirements of Sections 3 & 4 of Article II of its by-laws by developing and maintaining formal Executive and Finance committees.

As of December 31, 1999, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Joseph Dudley Sargent	President
Frank Joseph Jones	Executive VP & Chief Financial Officer
Earl Carlton Harry	Treasurer
Gary Bert Lenderink	Senior Vice President
Jeremy Starr	Vice President
Thomas George Sorell	Vice President
Rodolfo Esteban Fidelino, M.D.	Vice President & Chief Medical Officer
Sanford Barry Herman	Vice President & Actuary
Joseph Anthony Caruso	Vice President & Corporate Secretary
David Arthur Lorenson	Counsel
Jeffrey Landsman	Second Vice President & Controller

**B. Territory and Plan of Operation**

The Company is authorized to transact accident and health and non-cancelable disability insurance as defined in paragraph 3 of Section 1113(a) of the New York Insurance Law. It is licensed solely in the State of New York.

Based upon the line of business for which the Company is licensed, the Company's current capital structure and pursuant to the requirements of Articles 13 and 42 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$150,000. However, the Company is subject to Section 1322 of the New York Insurance Law (Risk Based Capital) and has made the required filings during the examination period.

Since the acquisition by Guardian, the Company ceased writing new business. The Company stated that it only writes renewal business and that it had no plans to write new business under the FICA name in the near future. An inquiry was made by the examiners with regard to

FICA's decision to discontinue writing, however, no further explanation was provided by the Company.

**C.     Holding Company System**

The following is a chart of the Company's holding company system as of December 31, 1999:



The Company is a wholly owned subsidiary of Guardian Life Insurance Company of America (“Parent”). Registration statements were filed pursuant to the provisions of Article 15 of the New York Insurance Law and Department Regulation Number 52. It was noted, however, that the Company stated in the general interrogatories in its filed 1999 annual statement that it is not a member of an insurance holding company system.

It is recommended that the Company provide accurate disclosures in the general interrogatories of its annual statements filed with this Department.

Further, a review of the Company’s affairs within the holding company system revealed that its Parent company provided administrative and management services for FICA. The Company is operating without an administrative or management service agreement filed with the Department of Insurance in violation of Section 1505(d)(3) of the New York Insurance Law, which states in part:

“(d) 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 of services on a regular or systematic basis.”

It is recommended that the Company comply with the provisions of Section 1505(d)(3) of the New York Insurance Law by formalizing an agreement detailing all recurring transactions between FICA and its Parent and filing the agreement with the Department for its non-disapproval.

**D. Third Party Administrator**

The Company's general operations are handled by Arista Insurance Company ("Arista"), a third party administrator (TPA), under a service agreement between Guardian and Arista. Arista is a former New York licensed insurance company that specialized in the statutory disability line of business. Arista handles all of FICA's daily operations, which include claims processing, premiums processing, and policy member services. Arista also administers Guardian's statutory disability line of business. FICA pays Arista a fee of 6% of premium dollars received. A review of FICA's board minutes did not indicate that the contract between Guardian and Arista was reviewed or approved by FICA's board of directors; nor is FICA a party to the agreement.

It is recommended that the agreement between Guardian and Arista be amended to formally include FICA, and that FICA's board of directors or management approve the agreement. In addition, the agreement should then be filed with the Department for its non-disapproval under Section 1505(d)(3) of the New York Insurance Law, as described earlier herein.

**Internal Audit Report**

Guardian's Operations Unit ("Unit") performs a semi-annual audit of Arista to ensure that the disability business is processed in accordance with Guardian's guidelines. It was noted that FICA does not have its own guidelines. The audit includes a review of claims and premiums handling by Arista. Guardian's Unit report indicates that Arista achieved the highest (best) score attainable and that service provided by Arista is more than satisfactory. However, the Unit indicated that policies sampled included only newly written disability business, which does not include any of FICA's

policies. Since new disability business is no longer written under FICA's paper, there were no FICA policies represented in the Unit's review.

It is recommended that all future audits of Arista by Guardian's Operations Unit include a sufficient representation of FICA policies during their sampling and review process.

It is recommended that FICA adopt its own guidelines as regards claims and premiums handling procedures.

**E. Reinsurance**

Prior to 1999, the Company's writings included assumed business consisting of student accident and sickness policies which were written throughout the United States by a carrier licensed to write such business in the applicable state. Since the acquisition year of 1999, the Company terminated contracts related to reinsurance and ceased assuming reinsurance business. A review of the runoff for the assumed reinsurance business showed that no claims reserve remain in the unpaid claim liability as of the examination date.

**F. Accounts and Records**

Special Deposit

A review of special deposits made in the name of the Superintendent of Insurance of New York indicated that the funds are held as cash. However, such deposits made in the Superintendent's

name should be held in securities specified under Section 1318(a) of the New York Insurance Law, which states in part:

“Deposits, securities eligible. (a) Except as otherwise provided in this chapter, every deposit made with the superintendent shall be in the securities specified in paragraphs one and two of subsection (b) of section one thousand four hundred two of this chapter, estimated at an amount not exceeding their current market value, but their total par value shall not be less than the amount required.”

It is recommended that the Company maintain required deposits made in the name of the Superintendent of New York to consist of approved securities as specified under Section 1318(a) of the New York Insurance Law.

#### FICA Prior Records

The Company maintains records that relate to information prior to its acquisition by Guardian in Bethlehem, Pennsylvania. However, the Company failed to locate corporate minutes from 1994 to 1996, and therefore they could not be reviewed by the examiners. New York Insurance Law Section 325(a) states in part:

“Every domestic insurer and every licensed United States branch of an alien insurer entered through this state shall, except as hereinafter provided, keep and maintain at its principal office in this state...if a domestic corporation the minutes of any meetings of its shareholders, policyholders, board of directors and committees thereof.”

It is recommended that the Company comply with the provisions of Section 325(a) of the New York Insurance Law.

**G. Significant Operating Ratios**

The underwriting ratios presented below are on an earned – incurred basis and encompass the six year period covered by this examination:

	<u>Amounts</u>	<u>Percentage</u>
Disability benefits and benefits under accident and health policies incurred	\$27,831,840	61.16%
Other underwriting expenses incurred	16,787,665	36.89%
Net underwriting gain	<u>887,394</u>	<u>1.95%</u>
Premium and annuity benefits	<u>\$45,506,899</u>	<u>100.00%</u>

**3. FINANCIAL STATEMENTS**

**A. Balance Sheet**

The following shows the assets, liabilities and surplus as regards policyholders as determined by this examination as of December 31, 1999. This statement is the same as the balance sheet contained in the Company's Annual Statement filed with the Department:

<u>Assets</u>	<u>Ledger Assets</u>	<u>Non-Ledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$1,939,335			\$1,939,335
Common stocks	327,361	\$ 123,196		450,557
Cash on hand and on deposit	1,853,715			1,853,715
Accident and health Premiums due and unpaid		1,550,000		1,550,000
Investment income due and accrued		27,655		27,655
Other asset	35,268		\$35,268	
Aggregate write-in for other than invested assets	_____	<u>907</u>	<u>907</u>	_____
Total assets	<u>\$4,155,679</u>	<u>\$1,701,758</u>	<u>\$36,175</u>	<u>\$5,821,262</u>

Liabilities

Aggregate reserve for accident and health policies	\$ 424,550
Accident and health policy and contract claims	1,080,170
Commissions to agents	247,162
General expenses	36,728
Federal and foreign income taxes	212,856
Amounts withheld	69,419
Remittances and items not allocated	177,234
Asset valuation reserve	126,727
Payable to parent, subsidiaries and affiliates	1,481,065
Disability benefits law assessment	<u>123,519</u>
Total liabilities	<u>\$ 3,979,431</u>
Common capital stock	\$150,000
Gross paid in and contributed surplus	350,000
Unassigned finds (surplus)	<u>1,341,832</u>
Surplus as regards policyholders	<u>\$ 1,841,832</u>
Total liabilities and surplus	<u>\$ 5,821,262</u>

The Internal Revenue Service has not conducted an audit of the income tax returns filed by the Company since the acquisition by Guardian. Guardian stated that it is not aware of any IRS audit of the Company for any taxable year. The stock purchase agreement with the owners of FICA states that the statute of limitations for all taxable years ending on or before December 31, 1995 has expired, so that all years through 1995 are closed. The examiner is unaware of any potential exposure of the Company to any further tax assessment and no liability has been established herein relative to such contingency.

**B. Underwriting and Investment Exhibit**

Surplus as regards policyholders increased by \$989,680 during the six year examination period from January 1, 1994 to December 31, 1999, detailed as follows:

**Statement of Income**

**Underwriting Income**

Premiums and annuity considerations earned		\$45,506,899
Deductions:		
Disability benefits and benefits accident and health policies	\$27,831,840	
Other underwriting expenses incurred	<u>16,787,665</u>	
Total underwriting deductions		<u>\$44,619,505</u>
Net underwriting gain		\$ 887,394

**Investment Income**

Net investment income earned	\$ 616,491	
Amortization of interest maintenance reserve	(817)	
Net realized capital gains	<u>1,215</u>	
Net investment gain		<u>\$ 616,889</u>
Net income before federal and foreign income taxes		\$ 1,504,283
Federal and foreign income taxes incurred		<u>494,738</u>
Net Income		<u>\$ 1,009,545</u>

**Capital and Surplus Account**

Surplus as regards policyholders per report on examination as of December 31, 1993		\$ 852,152
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>
Net income	\$1,009,545	
Change in non-admitted assets	123,198	
Change in provision for reinsurance		\$ 16,335
Change in assets valuation reserve	_____	<u>126,728</u>
Total gains and losses	<u>\$1,132,743</u>	<u>\$143,063</u>
Net increase in surplus funds		\$ <u>989,680</u>
Surplus as regards policyholders, per report on examination as of December 31, 1999		<u>\$1,841,832</u>

**4. UNEARNED PREMIUM RESERVE; ACCIDENT AND HEALTH POLICY AND CONTRACT CLAIMS**

The examination liability for unearned premium reserve; and accident and health policy and contract claims is the same as the amount reported by the Company as of December 31, 1999. A review of the one-year reserve runoff showed that the Company maintained adequate reserves to cover claims incurred at and prior to the exam date.

Unearned Premium Reserve	\$ 424,550
Policy and Contract Claims (IBNR)	<u>1,080,170</u>
Total	<u>\$ 1,504,720</u>

**5. MARKET CONDUCT ACTIVITIES**

In the course of this examination a review was made of the manner in which the Company conducts its business practices and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the generally more precise scope of a market conduct investigation. The review was further limited based upon the type of insurance and lack of new business during the past few years.

No problem areas were encountered.

**6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION**

The previous report on examination, as of December 31, 1993, contained five comments and recommendations as follows (page numbers refer to prior report):

<b><u>ITEM NO.</u></b>		<b><u>PAGE NO.</u></b>
1.	<b><u>Management</u></b>	
	It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.	4-5
	The Company replaced all existing board members at the time of the acquisition. The Company held only one meeting of its board of directors since the acquisition by Guardian in 1999, which is in violation of its corporate by-laws.	
2.	<b><u>Reinsurance</u></b>	
	It is recommended that the Company exclude extra contractual obligation coverage for punitive damages in its reinsurance assumed contracts.	6
	The Company cancelled all its reinsurance contracts prior to the acquisition by Guardian and no longer assumes reinsurance business.	
3.	<b><u>Holding Company System</u></b>	
	It is recommended, as it was in the prior examination, that FASCO immediately cease performing any duties as defined in Section 2101 of the New York Insurance Law without possessing a license to do so.	8
	The Company no longer utilizes the services of FASCO	
4.	<b><u>Accident and health premiums due and unpaid</u></b>	
	It is recommended, as it was in the prior examination that the Company adhere to the form of the Convention blank in future statement filings.	14
	The Company has complied with this recommendation.	

**7. SUMMARY OF COMMENTS AND RECOMMENDATIONS**

<b><u>ITEM NO.</u></b>	<b><u>PAGE NO.</u></b>
A. <u>Management</u>	
i. It is recommended that the Company comply with the requirements of New York Insurance Law Sections 1202(a)(1) and 1201(A)(5)(B)(v) and abide by its own by-laws.	4
ii. It is recommended that the board members of the Company schedule and attend meetings as required by its By-Laws.	5
iii. It is recommended that the Board of Directors be fully apprised of the Company's investments and financial position on a regular basis by management as required by Section 1411(a) of the New York Insurance Law.	6
iv. It is recommended that the Company comply with the requirements of Article II, Section 3 & 4 of its by-laws.	6
B. <u>Holding Company System</u>	
i. It is recommended that the Company provide accurate disclosures in its general interrogatories of the annual statement.	10
ii. It is recommended that the Company comply with the provisions of Section 1505(d)(3) of the New York Insurance Law by formalizing an agreement detailing all transactions covered by the statute between the two companies and filing the agreement with the Superintendent for his non-disapproval.	10
C. <u>Third Party Administrator</u>	
i. It is recommended that the agreement between Guardian and Arista be amended to formally include FICA, and that FICA's board of directors or management approve the agreement. In addition, the agreement should be filed with the Department for its non-disapproval under Section 1505(d)(3) of the New York Insurance Law.	11
ii. It is recommended that all future audits of Arista by Guardian's Operations Unit include a sufficient representation of FICA policies during their sampling and review process.	12
iii. It is recommended that FICA adopt its own guidelines as regards claims and premiums handling procedures.	12

D. Accounts and Records

- i. It is recommended that the Company maintain required deposits made in the name of the Superintendent of New York to consist of approved securities as specified under Section 1318(a) of the New York Insurance Law. 13
- ii. It is recommended that the Company comply with the provisions of Section 325(a) of the New York Insurance Law. 13

