



**REPORT ON EXAMINATION
OF THE
SEGREGATED GIFT ANNUITY FUND
OF THE
COVENANT HOUSE**

AS OF December 31, 2018

EXAMINER: James Wang

DATE OF REPORT: November 1, 2019

NEW YORK STATE DEPARTMENT OF FINANCIAL SERVICES

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KATHY HOCHUL
Governor



ADRIENNE A. HARRIS
Superintendent

February 7, 2022

Honorable Adrienne A. Harris
Superintendent of Financial Services
New York, New York 10004

Madam:

In accordance with instructions contained in Appointment No. 31903, dated May 16, 2019 and annexed hereto, an examination has been made into the condition and affairs of the Segregated Gift Annuity Fund of the Covenant House, at its home office located at 5 Penn Plaza, 3rd Floor, New York, NY 10001.

The report indicating the results of this examination is respectfully submitted.

1. EXECUTIVE SUMMARY

The Fund violated New York Insurance Law § 312(b) by failing to obtain signed statements from the board members indicating that they received and read the prior report on examination. The examiner recommends that the Fund comply with New York Insurance Law § 312(b) by obtaining the signature of each board member indicating that they have received and read any current or future filed report on examination. (See item 3E of this report)

The examiner recommends that the Fund obtain broker's advices or other supporting documentation for its investment transactions and that this documentation be reviewed on a timely basis and reconciled to the applicable custodial statements for that period. (See item 3E of this report)

The examiner recommends that the Fund adopt an Investment Policy Statement. Such a Statement should refer to the prudent investor standard as defined in Estates, Powers and Trusts Law § 11-2.3, which standard, as specified in New York Insurance Law § 1110(b), governs the manner in which the required admitted assets of a segregated gift annuity fund shall be invested. The Fund should exercise reasonable care, skill and caution to make and implement investment and management decisions as a prudent investor would for the entire portfolio. In doing so, the Fund should take into account present and future distributions to or for the beneficiaries and create a plan to meet the needs of those distributions to establish the ISS's risk, return, and time horizon objectives. This is a repeat recommendation. (See item 4(a) of this report)

The Fund violated New York Insurance Law § 1110(a) by using gift annuity agreement forms that differed from the gift annuity agreement forms that were filed with the Superintendent. The examiner recommends that the Fund file with the Superintendent all gift annuity agreement forms that were used and not previously filed with the Superintendent. (See item 6 of this report)

The examiner recommends that upon the death of an annuitant, the Fund obtain and maintain a death certificate or other reliable documentary evidence that supports such information terminating an annuity contract. (See item 6 of this report)

The examiner recommends that the Fund prepare its annual statements in accordance with the instructions for completing the New York State Segregated Gift Annuity Fund Annual Statement. (See item 7 of this report)

The Fund violated New York Insurance Law § 1110(b) by failing to segregate the stock donation from the date of donation as separate and distinct funds, independent of all other funds of such corporation or association. The examiner recommends that the Organization establish a segregated stock account solely for the purpose of the Gift Annuity Fund. The examiner further recommends that the Fund establish procedures to ensure that funds and securities are deposited in the investment account in a timely manner. (See item 8 of this report)

The examiner recommends that the Fund perform bank reconciliations at the end of each bank statement period and maintain such as part of its books and records. (See item 9 of this report)

The examiner recommends that the Fund review outstanding checks on a timely basis, especially those that are outstanding for a lengthy amount of time. This should include contacting the annuitant to ensure that the annuitant is still alive and that the address on file is still accurate, or that the check was not lost or misplaced. (See item 9 of this report)

2. SCOPE OF EXAMINATION

This Scope of Examination summarizes the nature of the Superintendent of the Department of Financial Services' (the "Department" or "DFS") examination and assessment of the Covenant House Segregated Annuity Fund (the "Fund") through which Covenant House (the "Organization") provides annuity benefits.

The prior examination was conducted as of December 31, 2013. This examination covers the period from January 1, 2014 through December 31, 2018. As necessary, the examiner reviewed transactions occurring subsequent to December 31, 2018 but prior to the date of this report (i.e., the completion date of the examination).

This report outlines DFS's supervisory expectations or priorities and articulates DFS's general views regarding the exceptional circumstances where the College or Fund, in relation to their annuity activities, could have better satisfied statutory standards or adhered to practices or methods of dealing that are regularly observed among similar circumstances.

The Fund is subject to the solvency and examination requirements of New York Insurance Law § 1110 and of New York Insurance Law articles 1, 2, 3, 25, and 74.

The investment of the Fund's required admitted assets is subject to N.Y. Estates, Powers and Trust Law § 11-2.3. The investment of the remainder of the Fund's admitted assets is subject to N.Y. Not-for-Profit Corporation Law Article 5-a. Both establish that the trustees are to invest the assets consistent with prudent person standards.

The examination comprised a verification of assets and liabilities as of December 31, 2018 to determine whether the Fund's filed 2018 annual statement fairly presents its financial condition. The examiner reviewed the Fund's income and disbursements necessary to accomplish such verification. The examiner also reviewed the corrective actions taken by the Fund with respect to the recommendations contained in the prior report on examination. The results of such review are contained in item 10 of this report.

3. DESCRIPTION OF FUND

A. History

Covenant House was chartered in 1972 and is organized for the purpose of providing shelter and services to young people. In addition to shelter, food, clothing and crisis care, the Organization provides health care, education, vocational preparation, recreation, legal services, drug abuse treatment, prevention programs, mother and child programs, transitional living programs, street outreach and aftercare. The Organization established the Fund to issue gift annuity agreements in return for gifts from donors in 1992. The Superintendent of Insurance granted to the Organization a Charitable Annuity Society special permit on October 24, 1994.

B. Structure

The management of the Organization and the Fund and all its affairs and property are entrusted to a board of directors.

C. Assets under the Board of Directors

As of the June 30, 2018 IRS Form 990, the Organization's Board of Directors oversaw an endowment comprising \$8,621,776 in total assets. The Fund, as of December 31, 2018, held total admitted assets of \$3,065,146.

D. Third-Party Payment Service Provider

Custodial and investment services are provided by Comerica Bank & Trust, N.A., a financial services company headquartered in Dallas, TX. Prior to January 22, 2019, administrative services, including preparation of the Fund's annual statements, were provided by Hemmenway & Reinhardt, Inc. ("H&R"). H&R prepared quarterly annuity payments for annuitants, calculated required and excess reserves, and prepared the Fund's annual statements. Effective January 22, 2019, all administrative services became handled by PG Calc Incorporated, as PG Calc had purchased H&R in 2018.

E. Oversight Structure

New York Insurance Law § 312(b) states, in part:

"(b) A copy of the report shall be furnished by such insurer or other person to each member of its board of directors and each such member shall sign a statement which shall be retained in the insurer's files confirming that such member has received and read such report . . ."

The examiners review revealed that the Fund failed to obtain statements signed by each board member indicating that they received and read the prior report on examination.

The Fund violated New York Insurance Law § 312(b) by failing to obtain signed statements from the board members indicating that they received and read the prior report on examination. The examiner recommends that the Fund comply with New York Insurance Law § 312(b) by obtaining the signature of each board member indicating that they have received and read any current or future filed report on examination

The examiner reviewed the investment transactions for the period under examination and noted that the Fund failed to obtain broker's advices or other supporting documentation for its investment transactions to reconcile such advices to the monthly statements furnished by the custodian.

The examiner recommends that the Fund obtain broker's advices or other supporting documentation for its investment transactions and that this documentation be reviewed on a timely basis and reconciled to the applicable custodial statements for that period.

4. INVESTMENT REVIEW

A. Investment Policy Statement

New York Estate Powers and Trust Law § 11-2.3(b)(3)(A) requires trustees to “pursue an overall investment strategy to enable the trustee[s] to make appropriate present and future distributions to or for the benefit of the beneficiaries under the governing instrument, in accordance with risk and return objectives reasonably suited to the entire portfolio.”

New York Not-for-Profit Corporation Law § 552(e)(2) calls for “an overall investment strategy having risk and return objectives reasonably suited to the fund and to the institution.” New York Not-for-Profit Corporation Law § 552(f) states that each “institution shall adopt a written investment policy setting forth guidelines on investments ... and delegation of management and investment functions in accord with the standards of this article.”

The examiner’s review revealed the Fund’s board of directors failed to adopt a written Investment Policy Statement (“IPS”). Such a statement should be reviewed at least annually to determine compliance.

The examiner recommends that the Fund adopt an Investment Policy Statement. Such a Statement should refer to the prudent investor standard as defined in Estates, Powers and Trusts Law § 11-2.3, which standard, as specified in New York Insurance Law § 1110(b), governs the manner in which the required admitted assets of a segregated gift annuity fund shall be invested. The Fund should exercise reasonable care, skill and caution to make and implement investment and management decisions as a prudent investor would for the entire portfolio. In doing so, the Fund should take into account present and future distributions to or for the beneficiaries and create a plan to meet the needs of those distributions to establish the IPS’s risk, return, and time horizon objectives.

5. ASSETS AND LIABILITIES SUMMARY

The following summary table indicates the decline in various categories of the Fund's assets, liabilities, and fund balance during the period under review:

	<u>December 31,</u> <u>2013</u>	<u>December 31,</u> <u>2018</u>	<u>Increase</u> <u>(Decrease)</u>
Admitted assets	<u>\$3,724,226</u>	<u>\$3,065,146*</u>	<u>\$(659,080)</u>
Liabilities	<u>\$2,876,815</u>	<u>\$2,376,912</u>	<u>\$(499,903)</u>
Minimum required fund balance	\$ 287,682	\$ 237,691	\$ (49,991)
Excess fund balance (surplus)	<u>559,729</u>	<u>450,543*</u>	<u>(109,186)</u>
Total annuity fund balance	<u>\$ 847,411</u>	<u>\$ 688,234*</u>	<u>\$(159,177)</u>
Total liabilities and annuity fund balance	<u>\$3,724,226</u>	<u>\$3,065,146*</u>	<u>\$(659,080)</u>

*Amounts calculated by the examiner. Please see Section 7 of this report for more details.

The decline in assets was due to the steady decline in the number of new gifts received during the examination period. The Organization was not proactively marketing the annuity program due to the retirement of the administrator of the program. In addition, the decline in the market during the years under examination caused some of the decrease in the value of the assets. The decline in liabilities was directly due to the decrease in the new annuity contracts over this examination period. As distributions and terminated annuitants reduce the liabilities, there have not been enough new contracts to replace them.

The Fund's admitted assets, as of December 31, 2018, were invested mainly in equity securities (59.92%) and bonds (31.02%).

6. TREATMENT OF ANNUITANTS

The examiner reviewed a sample of annuity files to determine whether the annuitants were treated fairly and in accordance with the provisions of the annuity agreements. The examination also consisted of a review of the various controls involved, a check of the accuracy of the computations and the tracing of accounting data to the books of account.

New York Insurance Law § 1110(a) states, in part:

“. . . Every such corporation or association shall, before making such agreement, file with the superintendent copies of its forms of agreements with annuitants . . .”

The examiner’s review of a sample of 12 newly issued gift annuities by the Fund during the examination period noted that in all 12 newly issued annuities, the Fund used forms that differed from the gift annuity agreements filed with the Superintendent. The deviating forms found in the sample are GA1F, GA1-15, and CRA1-15.

The Fund violated New York Insurance Law § 1110(a) by using gift annuity agreement forms that differed from the gift annuity agreement forms that were filed with the Superintendent. The examiner recommends that the Fund file with the Superintendent all gift annuity agreement forms that were used and not previously filed with the Superintendent.

The examiner’s review of a sample of 26 annuity contracts terminated revealed that in 4 of the 26 cases (15.38%) reviewed, the Fund did not obtain a copy of the death certificate to confirm termination of the annuity contract.

The examiner recommends that upon the death of an annuitant, the Fund obtain and maintain a death certificate or other reliable documentary evidence that supports such information terminating an annuity contract.

7. ANNUAL STATEMENT REPORTING

The Fund reported total assets of \$3,072,758, excess fund balance of \$458,155 and annuity fund balance of \$695,846 as of December 31, 2018. The Fund should have reported total asset balance of \$3,065,146, excess fund balance of \$450,543 and total annuity fund balance of \$688,234.

The instructions for line 1 of the Income section of the annual statement states the following:

“Line 1 “Current Year” Column: Should reflect the gross amount of gifts received during the year conditioned upon annuity agreements.

“Prior Year” Column: Report the prior year’s gross amount of gifts received conditioned upon annuity agreements.

The examiner’s review of the gifts received during the years 2015 through 2017 revealed the following differences between the amount of gifts received per Page 3, line 1 of the income statement in the Fund’s filed annual statements and the amount of gifts received per the reserve listings:

	2015	2016	2017
Gifts Received During the Year per Pg. 3, Line 1 of the Annual Statement	\$235,181	\$207,628	\$162,688
Gifts Received Per Reserve Listing	\$325,181	\$117,628	\$172,688

The examiner determined that the discrepancy in 2015 and 2016 was due mainly to \$90,000 worth of new gifts issued at the end of 2015 that was erroneously reflected in the 2016 statement. The other \$10,000 was not properly accounted for by the Fund, in the course of the examiner’s inquiry.

The examiner recommends that the Fund prepare its annual statements in accordance with the instructions for completing the New York State Segregated Gift Annuity Fund Annual Statement.

8. SEGREGATION OF GIFT ANNUITY FUNDS

New York Insurance Law § 1110(b) states, in part,

“Such assets shall be segregated as separate and distinct funds, independent of all other funds of such corporation or association, and shall not be applied to pay its debts and obligations or for any purpose except the aforesaid annuity benefits.”

The examiner’s review of seven stock donations gifted during the exam period revealed that in all seven cases, the stocks were initially deposited in the Society’s general operating account before being liquidated and transferred to the Fund’s segregated account. In five out of seven cases, it took between four months and one year for the gifted amount to be transferred from the Society’s general operating account to the Fund’s segregated account. In two out of seven cases, in which the donations were from 2016, to date the amount has yet to be transferred from the Society’s general operating account to the Fund’s segregated account.

The Fund violated New York Insurance Law § 1110(b) by failing to segregate the stock donation from the date of donation as separate and distinct funds, independent of all other funds of such corporation or association. The examiner recommends that the Organization establish a segregated stock account solely for the purpose of the Gift Annuity Fund. The examiner further recommends that the Fund establish procedures to ensure that funds and securities are deposited in the Fund’s investment account in a timely manner.

9. INTERNAL CONTROLS

The examiner requested bank reconciliations for the years ended 2014 and 2016. The Fund responded stating that it did not have bank reconciliations for the year end cash balances. A bank reconciliation is an important element of internal control with which to arrive at the true bank balance, adding deposits in transit and deducting outstanding checks, and making other reconciling adjustments. Without performing a bank reconciliation, or showing evidence of such reconciliation, a gift annuity fund operator may not know the true cash balance at that point in time, an important element of preventing fraud or ensuring the solvency of the fund.

The examiner recommends that the Fund perform bank reconciliations at the end of each bank statement period and maintain such as part of its books and records.

The examiner noted a large number of outstanding checks during his review of the 2015 year end bank reconciliation. Some checks were outstanding for numerous years. The examiner raised questions concerning the large number of outstanding checks shown on the 2015 year end bank reconciliation. The Fund was unable to provide detail concerning those payments.

The examiner recommends that the Fund review outstanding checks on a timely basis, especially those that are outstanding for a lengthy amount of time. This should include contacting the annuitant to ensure that the annuitant is still alive and that the address on file is still accurate, or that the check was not lost or misplaced. Checks outstanding for a lengthy amount of time should be canceled and reissued, to prevent possible fraud, and also help the annuitant in cases where the check was lost or misplaced.

10. PRIOR REPORT SUMMARY AND CONCLUSIONS

Following are the recommendations contained in the prior report on examination and the subsequent actions taken by the Fund in response to each citation:

<u>Item</u>	<u>Description</u>
A	<p>The examiner recommends that the board of directors, or a committee thereof, approve the purchases and sales of all investments and note such approvals in the minutes</p> <p>There was no IPS adopted during the examination period, which would provide for how the Fund's investments would be reviewed by the board, or a committee thereof.</p>
B	<p>The examiner recommends that the Fund diversify its investment holdings.</p> <p>The Department no longer provides guidance for diversification.</p>
C	<p>The examiner recommends that the Fund adopt an Investment Strategy Statement. The Fund should exercise reasonable care, skill and caution to make and implement investment and management decisions as a prudent investor would for the entire portfolio. In doing so, the Fund should take into account present and future distributions to or for the beneficiaries and create a plan to meet the needs of those distributions to establish the ISS's risk, return, and time horizon objectives.</p> <p>The Fund still did not adopt an IPS. A similar recommendation appears in this report on examination.</p>

11. SUMMARY AND CONCLUSIONS

Following are the violations and recommendations contained in this report:

<u>Item</u>	<u>Description</u>	<u>Page No(s).</u>
A	The Fund violated New York Insurance Law § 312(b) by failing to obtain signed statements from the board members indicating that they received and read the prior report on examination.	6
B	The examiner recommends that the Fund comply with New York Insurance Law § 312(b) by obtaining the signature of each board member indicating that they have received and read any current or future filed report on examination.	6
C	The examiner recommends that the Fund obtain broker's advices or other supporting documentation for its investment transactions and that this documentation be reviewed on a timely basis and reconciled to the applicable custodial statements for that period.	6
D	The examiner recommends that the Fund adopt an Investment Policy Statement. Such a Statement should refer to the prudent investor standard as defined in Estates, Powers and Trusts Law § 11-2.3, which standard, as specified in New York Insurance Law § 1110(b), governs the manner in which the required admitted assets of a segregated gift annuity fund shall be invested. The Fund should exercise reasonable care, skill and caution to make and implement investment and management decisions as a prudent investor would for the entire portfolio. In doing so, the Fund should take into account present and future distributions to or for the beneficiaries and create a plan to meet the needs of those distributions to establish the IPS's risk, return, and time horizon objectives.	7
E	The Fund violated New York Insurance Law § 1110(a) by using gift annuity agreement forms that differed from the gift annuity agreement forms that were filed with the Superintendent.	9
F	The examiner recommends that the Fund file with the Superintendent all gift annuity agreement forms that were used and not previously filed with the Superintendent.	9

<u>Item</u>	<u>Description</u>	<u>Page No(s).</u>
G	The examiner recommends that upon the death of an annuitant, the Fund obtain and maintain a death certificate or other reliable documentary evidence that supports such information terminating an annuity contract.	9
H	The examiner recommends that the Fund prepare its annual statements in accordance with the instructions for completing the New York State Segregated Gift Annuity Fund Annual Statement.	10
I	The Fund violated New York Insurance Law § 1110(b) by failing to segregate the stock donation from the date of donation as separate and distinct funds, independent of all other funds of such corporation or association.	11
J	The examiner recommends that the Organization establish a segregated stock account solely for the purpose of the Gift Annuity Fund.	11
K	The examiner further recommends that the Fund establish procedures to ensure that funds and securities are deposited in the investment account in a timely manner.	11
L	The examiner recommends that the Fund perform bank reconciliations at the end of each bank statement period and maintain such as part of its books and records.	12
M	The examiner recommends that the Fund review outstanding checks on a timely basis, especially those that are outstanding for a lengthy amount of time. This should include contacting the annuitant to ensure that the annuitant is still alive and that the address on file is still accurate, or that the check was not lost or misplaced.	12

Respectfully submitted,

_____/s/
James Wang
Senior Insurance Examiner

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

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

_____/s/
James Wang

Subscribed and sworn to before me
this _____ day of _____

APPOINTMENT NO. 31903

NEW YORK STATE

DEPARTMENT OF FINANCIAL SERVICES

I, **LINDA A. LACEWELL**, Acting Superintendent of Financial Services of the State of New York, pursuant to the provisions of the Financial Services Law and the Insurance Law, do hereby appoint:

JAMES WANG

as a proper person to examine the affairs of the

**SEGREGATED GIFT ANNUITY FUND OF THE
COVENANT HOUSE**

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

FUND

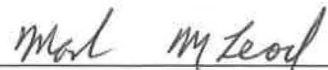
with such other information as he shall deem requisite.

In Witness Whereof, I have hereunto subscribed my name
and affixed the official Seal of the Department
at the City of New York

this 16th day of May, 2019

LINDA A. LACEWELL
Acting Superintendent of Financial Services

By:



MARK MCLEOD
DEPUTY CHIEF - LIFE BUREAU

