

NEW YORK STATE DEPARTMENT OF FINANCIAL SERVICES
REPORT ON EXAMINATION
OF THE
SEGREGATED GIFT ANNUITY FUND
OF THE
HOUGHTON COLLEGE

CONDITION:

DECEMBER 31, 2017

DATE OF REPORT:

SEPTEMBER 20, 2018

NEW YORK STATE DEPARTMENT OF FINANCIAL SERVICES

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EXAMINER:

ASHOK REDDY

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Department of Financial Services

KATHY HOCHUL
Governor

ADRIENNE A. HARRIS
Superintendent

February 1, 2022

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

Madam:

In accordance with instructions contained in Appointment No. 31372, dated April 13, 2018 and annexed hereto, an examination has been made into the condition and affairs of the Segregated Gift Annuity Fund of the Houghton College, hereinafter referred to as “the Fund.” The Fund’s home office is located at One Willard Avenue, Houghton, New York 14744.

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

1. EXECUTIVE SUMMARY

The examiner recommends that the Fund obtain broker's advices or other supporting documentation for its investment transactions and reconcile such advices to the monthly statements provided by the custodian. (See item 3C of this report)

The examiner recommends that the Fund adopt an Investment Strategy Statement that refers to the prudent investor standard as defined in Section 11-2.3 of the Estates, Powers and Trusts Law, which standard, as specified in Section 1110(b) of the New York Insurance Law, 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. (See item 3C(i) of this report)

The examiner recommends that the Fund's investments be further diversified. If the Fund's board of trustees reasonably determines that it is in the interest of the beneficiaries not to diversify, then a proper memorialization of either decision and the supporting rationale, should be prepared when that decision is made. (See item 3C(ii) of this report)

The examiner's review of the Fund's treatment of annuitants did not reveal significant instances which deviated from the New York Insurance Law, Department regulations and circular letters and the operating rules of the Fund. (See item 5 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 Houghton College Segregated Gift Annuity Fund (the "Fund") through which the Houghton College (the "College") provides annuity benefits.

The prior examination was conducted as of December 31, 2012. This examination covers the period from January 1, 2013 through December 31, 2017. As necessary, the examiner reviewed transactions occurring subsequent to December 31, 2017 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, 2017 to determine whether the Fund's filed 2017 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 recommendation contained in the prior report on examination. The results of such review are contained in item 6 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 FUND

A. History

Houghton College is organized for the purpose of providing an academically challenging Christ-centered education in the liberal arts and sciences to students from diverse traditions and economic backgrounds and equips them to lead and labor as scholar-servants in a changing world. The College established a program to issue gift annuity agreements in return for gifts from donors, and it has done so since 1971. A special permit was granted to the organization by the Department on August 19, 1977, authorizing it to issue gift annuity agreements as specified in Section 1110 of the New York Insurance Law.

B. Third Party Investment and Other Servicers

The solicitation of gifts, donor relations and general ledger accounting functions are handled by the College. Investments, payments to beneficiaries, tax reporting and actuarial functions are performed by the custodian, Key Bank National Association. Preliminary preparation of the annual statement is performed by the Olbricht Storniolo (OS) Group, LLC, while the College handles the final preparation and submission of the Fund's annual statement.

C. Oversight Structure

The management of the College and the Fund and all of its affairs and property are entrusted to a board of trustees. The number of trustees is limited to 35 regular voting trustees. As of December 31, 2017, the board consisted of 33 trustees. The trustees elect the President, district representatives, representatives-at-large and general board administration representatives. The nomination and election procedures of the trustees and their terms of office are set by the by-laws.

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 reconcile such advices to the monthly statements provided by the custodian.

Investment Strategy and Review

(i) Investment Strategy 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 of the Fund’s Investment Strategy Statement showed that it failed to contain reference to the prudent investor standard, as specified in Section 1110(b) of the New York Insurance Law.

The examiner recommends that the Fund adopt an Investment Strategy Statement that refers to the prudent investor standard as defined in Section 11-2.3 of the Estates, Powers and Trusts Law, which standard, as specified in Section 1110(b) of the New York Insurance Law, 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.

(ii) Diversification

New York Estate Powers and Trust Law § 11-2.3(b)(2)(C) requires a trustee to diversify assets unless the trustee reasonably determines that it is in the interests of the beneficiaries not to diversify. Compliance is to be determined in light of facts and circumstances prevailing at the time of the investment decision.

New York Not-for-Profit Law § 552(e)(4) states,

“(4) An institution shall diversify the investments of an institutional fund unless the institution prudently determines that, because of special circumstances, the purposes of the fund are better served without diversification. An institution shall review a decision not to diversify as frequently as circumstances require, but at least annually.”

The Fund has 15.47% of its admitted assets invested in the securities of Dodge & Cox International Stock Fund; and 11.35% invested in the JP Morgan US Equity Fund.

In addressing how to assess whether a trustee has been prudent, New York’s highest court, the Court of Appeals, has held that a statute did not change the applicability of appropriate benchmarks or methodologies used to assess an investor’s actions. *Matter of Janes*, 90 N.Y.2d 41 (1997) (affirming a judgment imposing a surcharge against petitioner for failure to diversify and inattentiveness). Thus, one can look to aptly analogous sources for benchmarks against which to assess a charitable annuity society portfolio’s diversification.

The annuity business is a type of life insurance business. This is illustrated by the required admitted asset requirement of the Charitable Annuity Society statute’s reference to New York Insurance Law § 4217.

Thus, while New York Insurance Law § 1409 does not apply directly to charitable gift annuity societies, its provisions, that are applied as to annuity providers generally, are apt as instructive guides to proper diversification.

New York Insurance Law § 1409 establishes a default limit on asset concentration for all entities. Exposure to all of the issuances of any one institution is limited to ten percent of the investor’s admitted assets.

As the Fund’s investments include funds registered under the Investment Company Act of 1940, New York Insurance Law § 1404(a)(10) and the Department’s consideration of that provision provide further guidance. When assessing a portfolio’s diversification, the Department regards investments in those securities as separate and distinct from the underlying securities held by that investment company. As a result, the Department does “look through” a fund to the underlying investments.

The examiner observed no record of specific Board discussion or action in regard to adhering to the 10% diversification standard.

The examiner recommends that the Fund’s investments be further diversified. If the Fund’s board of trustees reasonably determines that it is in the interest of the beneficiaries not to diversify,

then a proper memorialization of either decision and the supporting rationale, should be prepared when that decision is made.

4. SIGNIFICANT FINANCIAL INFORMATION

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

	<u>December 31,</u> <u>2012</u>	<u>December 31,</u> <u>2017</u>	<u>Increase</u> <u>(Decrease)</u>
Admitted assets	\$ <u>1,886,393</u>	\$ <u>2,107,060</u>	\$ <u>220,667</u>
Liabilities	\$ <u>1,278,576</u>	\$ <u>892,252</u>	\$(<u>386,056</u>)
Minimum required fund balance	\$ 127,858	\$ 88,252	\$ (39,606)
Excess fund balance (surplus)	<u>479,960</u>	<u>1,126,288</u>	<u>646,328</u>
Total annuity fund balance	\$ <u>607,818</u>	\$ <u>1,214,540</u>	\$ <u>606,722</u>
Total liabilities and annuity fund balance	\$ <u>1,886,393</u>	\$ <u>2,107,060</u>	\$ <u>220,666</u>

The increase in assets is attributable to income from investment activity, changes in gifts received, and transfers to the general fund of the college. Liabilities decreased due to a reduction in annuities in force stemming from terminations. Total annuities in-force decreased from 112 with annualized payments of \$170,710 as of December 31, 2012 to a total of 75 with annualized payments of \$111,672 as of December 31, 2017.

The increase in annuity fund balance is due to investment gains and a reduction in annuity payments due to terminated gifts..

The Fund's admitted assets, as of December 31, 2017, were invested mainly in equity securities (88.03%), bonds (9.77%), and in money market mutual funds (2.15%).

5. 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.

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

6. PRIOR REPORT SUMMARY AND CONCLUSIONS

Following is the recommendation contained in the prior report on examination and the subsequent action taken by the Fund in response to the citation:

<u>Item</u>	<u>Description</u>
A	<p>The examiner recommends that the Fund prepare its filed annual statements according to the Department's instructions.</p> <p>The examiner noted no new or continuing discrepancies in the Fund's annual statements.</p>

7. SUMMARY AND CONCLUSIONS

Following are the recommendations contained in this report:

<u>Item</u>	<u>Description</u>	<u>Page No(s).</u>
A	The examiner recommends that the Fund obtain broker's advices or other supporting documentation for its investment transactions and reconcile such advices to the monthly statements provided by the custodian.	4
B	The examiner recommends that the Fund adopt an Investment Strategy Statement that refers to the prudent investor standard as defined in Section 11-2.3 of the Estates, Powers and Trusts Law, which standard, as specified in Section 1110(b) of the New York Insurance Law, 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.	5
C	The examiner recommends that the Fund's investments be further diversified. If the Fund's board of trustees reasonably determines that it is in the interest of the beneficiaries not to diversify, then a proper memorialization of either decision and the supporting rationale, should be prepared when that decision is made.	6

Respectfully submitted,

_____/s/
Ashok Reddy
Senior Examiner

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

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

_____/s/
Ashok Reddy

Subscribed and sworn to before me
this _____ day of _____

APPOINTMENT NO. 31733

NEW YORK STATE

DEPARTMENT OF FINANCIAL SERVICES

I, MARIA T. VULLO, 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:

ASHOK REDDY

as a proper person to examine the affairs of the

**SEGREGATED GIFT ANNUITY FUND OF THE
HOUGHTON COLLEGE**

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 13th day of April, 2018

MARIA T. VULLO
Superintendent of Financial Services

By:

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MARK MCLEOD
DEPUTY CHIEF - LIFE BUREAU

