

**STATE OF ALABAMA
DEPARTMENT OF INSURANCE
MONTGOMERY, ALABAMA**

REPORT OF
ASSOCIATION EXAMINATION
OF
LIFE INSURANCE COMPANY OF ALABAMA

GADSDEN, ALABAMA

AS OF
DECEMBER 31, 2008

PARTICIPATION:
SOUTHEASTERN ZONE
ALABAMA

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EXAMINER AFFIDAVIT

STATE OF ALABAMA

COUNTY OF ETOWAH

Blase Francis Abreo, being duly sworn, states as follows:

1. I have authority to represent Alabama in the examination of Life Insurance Company of Alabama
2. Alabama is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.
3. I have reviewed the examination work papers and examination report, and the examination of Life Insurance Company of Alabama was performed in a manner consistent with the standards and procedures required by the state of Alabama.

The affiant says nothing further.

Francis Blase Abreo

Blase Francis Abreo, CFE

Subscribed and sworn before me by Francis Blase Abreo on this 8th day of April, 2010.

Libby Belyen
(Signature of Notary Public)

My commission expires May 10, 2010



BOB RILEY
GOVERNOR

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STATE FIRE MARSHAL
EDWARD S. PAULK
GENERAL COUNSEL
REYN NORMAN
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DENISE B. AZAR
LICENSING MANAGER
JIMMY W. GUNN

Gadsden, Alabama
April 8, 2010

Honorable Bill Harrington, Chief Examiner
Chairman, Examination Oversight
Ohio Department of Insurance
50 West Town Street, Third Floor, Suite 300
Columbus, OH 43214

Honorable Mary Jo Hudson, Director
Secretary, Midwestern Zone
Ohio Department of Insurance
50 West Town Street, Third Floor, Suite 300
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Honorable James J. Donelon, Commissioner
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Louisiana Department of Insurance
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Baton Rouge, LA 70804-9214

Honorable Jim L. Ridling
Commissioner of Insurance
Alabama Department of Insurance
201 Monroe Street, Suite 1700
Montgomery, Alabama 36104-3350

Dear Commissioners and Directors:

Pursuant to your instructions and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners, a full scope financial and market conduct examination as of December 31, 2008, has been made of

LIFE INSURANCE COMPANY OF ALABAMA.

at its home office located at 302 Broad Street, Gadsden Alabama. The report of examination is submitted herewith.

Where the description "Company" or "LICOA" appears herein, without qualification, it will be understood to indicate LIFE INSURANCE COMPANY OF ALABAMA.

EQUAL OPPORTUNITY EMPLOYER

SCOPE OF EXAMINATION

The Company was last examined for the four-year period ended December 31, 2003. The current examination covers the intervening period from January 1, 2004 through December 31, 2008, and was conducted by examiners from Alabama representing the Southeastern Zone, NAIC. Where deemed appropriate, transactions, activities and similar items subsequent to December 31, 2008, were reviewed.

The examination was conducted in accordance with applicable statutory requirements of the State of Alabama Insurance Code and the Alabama Insurance Department regulations and bulletins in addition to the procedures and guidelines promulgated by the National Association of Insurance Commissioners (NAIC), as deemed appropriate, and in accordance with generally accepted examination standards and practices.

The examination was conducted in accordance with the NAIC Financial Condition Examiners Handbook. The examination was planned and performed to evaluate the financial condition of the Company as of December 31, 2008, and to identify the Company's prospective risks by obtaining information about the Company including corporate governance. In addition, the examination was planned and performed to identify and assess inherent risks within the Company and to evaluate system controls and procedures used to mitigate those risks. The examination also included assessing the principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements, management's compliance with statutory accounting principles and annual statement instructions.

An examination of the Company's information systems (IS) was conducted concurrently with the financial examination. The IS examination included a review of management and organizational controls, logical and physical security controls, changes in application controls, system and program development controls, contingency planning controls, service provider controls, operation controls, processing controls, and network and internet controls.

A market conduct examination was performed concurrently with the financial examination. The market conduct examination included a review of the Company's territory and plan of operation, advertising, agents/representatives, claims processing, marketing and sales, policy forms and underwriting, policyholder complaints and privacy standards. See the caption MARKET CONDUCT ACTIVITIES.

The Company's annual statements for each year under examination were compared with or reconciled to the corresponding general ledger account balances.

During the examination period, the Company was audited annually by Barfield, Murphy, Shank & Smith PC, certified public accountants (CPA's). The CPA's workpapers were reviewed for all years under examination and were used in the examination as deemed appropriate by the examiners.

A signed certificate of representation was obtained during the examination. In this certificate, management attested to having valid title to all assets and to the nonexistence of unrecorded liabilities as of December 31, 2008.

ORGANIZATION AND HISTORY

The Company was incorporated in Etowah County on July 28, 1952 under the laws of the state of Alabama and commenced business on August 13, 1952.

The charter empowered the Company to engage in the life insurance business and the writing and making of life insurance contracts and issuing of life insurance policies of every lawful kind on the lives of human beings; and also the writing and making of insurance contracts and issuing of insurance policies of every lawful kind for health and accident insurance, insuring against injury or disability to the person by reason of accidents, illness and disease; and insuring against loss of earnings and medical and hospital expenses caused by bodily injury, illness and disease, and insuring against other causes or contingencies such as may impair or affect the life and health of a person; and generally to engage in the writing, making and issuing of contracts of life, health and accident insurance, to individuals or groups, upon such terms, conditions and provisions as may be permitted by law.

The original charter provided for authorized capital of \$500,000 comprised of 100,000 shares of \$5 par value per share common stock. The Company commenced business with 26,000 shares issued and outstanding, which provided paid-up capital of \$130,000 and surplus of \$65,000.

In 1956, the Company's charter was amended to increase the total authorized capital to \$1,000,000, with an additional 500,000 shares of common stock being authorized at a par value of \$1 per share. The \$1 par value stock was designated as Class "A" common.

In 1958, Life and Accident Insurance Company of Alabama, Gadsden, Alabama, was merged into the Company. This merger was effected through an exchange of stock, which resulted in an increase to the Company's assets of \$572,605 and an increase to insurance in-force of \$4,671,981.

In 1966, the charter was again amended to increase the total authorized capital to \$2,000,000, comprised of 100,000 shares of \$5 par value per share common stock and 1,500,000 shares of \$1 par value per share common stock.

In 1968, an amendment to the charter defined the preemptive rights of stockholders as follows:

“(a) The holders of “CLASS “A” COMMON STOCK” of the corporation shall have no pre-emptive rights to purchase any portion or part of any class of stock of the corporation, including “COMMON STOCK”, and “CLASS “A” COMMON STOCK”, and also including Treasury Shares of both of said Classes of Stock, that may be issued or offered for sale by the corporation:

(b) The holders of “COMMON STOCK” of the corporation shall have no pre-emptive rights to purchase any portion or part of any “CLASS “A” COMMON STOCK”, including Treasury Shares of “CLASS “A” COMMON STOCK”, that may be offered or issued for sale by the corporation:

(c) Every holder of “COMMON STOCK” of the corporation shall have the pre-emptive right to purchase his portion of any “COMMON STOCK”, including Treasury Shares of “COMMON STOCK”, that may be issued or offered for sale by the corporation, according to the proportion of his holdings of such “COMMON STOCK”, at such price, which may be in excess of par value, within such time and on such terms as shall be fixed and determined by the Board of Directors of the corporation.”

In 1977, the Company acquired all of the policies in force of Vanguard Security Life Insurance Company, Montgomery, Alabama pursuant to an agreement executed with the court appointed receiver of said company.

In 1978, the Company acquired College Investment Company of Gadsden, Alabama as a wholly-owned subsidiary of the Company and liquidated that Company during 1978.

In 1979, the Company acquired certain policies of the Life Insurance Company of America, Birmingham, Alabama pursuant to an agreement executed with the court appointed receiver of said company.

In 1987, the capital stock of the Company was increased by \$75,364 as a result of the increase in par value of the Class “A” common stock from \$1 per share to \$1.12 per share. This change in the par value of the Class “A” common stock increased the

total authorized under this class of stock to \$1,680,000, which exceeded the \$1,500,000 authorized by the Company's Charter. On February 8, 1993, the Company decreased the par value of the Class "A" common stock from \$1.12 to \$1. Also, on February 8, 1993, the Company issued 371,963 shares of authorized but unissued Class "A" common stock as treasury stock to meet the requirements of the state of Georgia.

These changes resulted in an issued and authorized capitalization of \$500,000 (common stock) and \$1,000,000 (Class "A" common stock) for an aggregate of \$1,500,000. 12,452 shares of common stock (\$5 par) and 412,496 shares of Class "A" common stock (\$1 par) were held by the Company as treasury stock at a net repurchase cost of \$727,342.

On December 31, 2008, the authorized capital of the Company was \$2,000,000 consisting of 100,000 shares of \$5 par value per share common stock, and 1,500,000 shares of \$1 par value Class "A" common stock. The issued capital stock was \$1,500,000, comprised of 100,000 shares of \$5 par value per share common stock and 1,000,000 shares of \$1 par value per share Class "A" common stock.

The 2008 Annual Statement indicated the following:

- Net Admitted Assets: \$81,802,863
- Liabilities: \$65,664,431
- Total Capital and surplus:
 - Common capital stock: \$1,500,000
 - Gross paid in and contributed surplus: \$1,773,659
 - Unassigned funds (surplus): \$13,592,115
 - Treasury stock at cost: \$727,342

MANAGEMENT AND CONTROL

Stockholders

The Company is a stock corporation organized under the laws of Alabama, with the ultimate control residing with the stockholders of the Company. The common stock of the Company is made up of two classes of common stock, with each class fully participating on a pro-rata basis according to par value. The common class shares of common stock have a \$5 par value, and have one vote per share on all matters that come before the shareholders at the shareholders' meetings. The class "A" shares of

common stock has a \$1 par value, and has a one-fifth vote per share on matters pertaining to the disposition of the entire properties of the Corporation, the consolidation and merger of the Corporation, and the dissolution of the Corporation.

Board of Directors

Members elected to the Board of Directors by the stockholders on May 19, 2008 and serving at December 31, 2008 were as follows:

<u>Name and Residence</u>	<u>Principal Occupation</u>
Clarence William Daugette, III Gadsden, Alabama	President and Chairman of the Board Life Insurance Company of Alabama
Robert Wooten Echols, Jr. Gadsden, Alabama	Councilman Gadsden City Council
Herman Warren Cobb Dothan, Alabama	Attorney Cobb, Derrick, Boyd & White
Anne Daugette Renfrow Gadsden, Alabama	Homemaker
James Wesley Cameron Montgomery, Alabama	Attorney Cameron & Cameron
Alburta Daugette Lowe Gadsden, Alabama	Homemaker
Mark Carroll Espy, Sr. Headland, Alabama	President The Headland National Bank
William Owen Leach, Jr. Gadsden, Alabama	President Leach & Company
Raymond Rudolph Renfrow, Jr. Gadsden, Alabama	Executive VP & Chief Marketing Officer Life Insurance Company of Alabama
Marvin Lynn Lowe Gadsden, Alabama	Executive Vice President & Treasurer Life Insurance Company of Alabama
Gerald Ray Smith, Jr. Gadsden, Alabama	Chairman, Company's Audit Committee CEO of Keystone Bank
Thomas Wesley Miller, Sr. Birmingham, Alabama	Vice President Marketing Nexcel Synthetics

Officers

Officers elected by the Board of Directors on May 19, 2008 and serving at December 31, 2008 were as follows:

<u>Officers</u>	<u>Title</u>
Clarence William Daugette, III	President and Chairman of the Board
Marvin Lynn Lowe	Executive VP and Treasurer
Raymond Rudolph Renfrow, Jr.	Executive VP and Chief Marketing Officer
Robert Larry Crowe	Senior VP and Secretary
David Augustus Behrens	Senior VP and Underwriting
Hoyt Russel Casey	VP Claims Administration and Reinsurance
Katrina Davis Hulsey	VP Accounting and Financial Reporting
Clarence Weyman Bracewell Jr.	VP Agency Director
Jeffrey Lynn Casey	VP Information Technology
Wanda Jean Snyder	VP Information Systems
Libby Alaine Belyeu	Assistant VP and Assistant Treasurer
Rosalie Renfrow Causey	Assistant VP and Assistant Secretary

Board Committees

The following committees were appointed by the Board of Directors and were the active committees of the Board of Directors as of December 31, 2008:

<u>Executive Committee</u>	
Clarence William Daugette, III, Chairman	Robert Wooten Echols, Jr.
William Owen Leach, Jr.	
<u>Audit Committee</u>	
Gerald Ray Smith, Jr., Chairman	Robert Wooten Echols, Jr.
William Owen Leach, Jr.	
<u>Compensation Committee</u>	
Herman Warren Cobb	Mark Carroll Espy, Sr.
Thomas Wesley Miller, Sr.	
<u>Loan and Investment Committee</u>	
Clarence William Daugette, III	Robert Wooten Echols, Jr.
Marvin Lynn Lowe	Raymond Rudolph Renfrow, Jr.

The minutes of the audit committee meetings for the years 2004 - 2008 were reviewed. The examiners determined that the Company did not document the review of the letters to the audit committee by the external auditors and the actions taken by the audit committee as required by ALA. CODE § 10-2B-16.01 (1975), which states:

“A corporation shall keep as permanent records minutes of all meetings of its shareholders and board of directors, a record of all actions taken by the shareholders or board of directors without a meeting, and a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation.”

CONFLICT OF INTEREST

The Company has an established procedure whereby the directors, officers and key employees of the Company sign a conflict of interest statement annually to disclose any conflict of interest or conflicting affiliations the individuals might have in their position with the Company. The conflicts of interest policy is part of the Company's "Employee Handbook," which was effective November 2006 and is under section 3.0: CODE OF ETHICS.

The examiners determined that there were two individuals who were elected to the Board of Directors in 2005 after the conflict of interest statements were signed for that year, and therefore did not sign a statement during 2005. This was not in compliance with the Company's policies and procedures pertaining to conflict of interest forms, as well as ALA. CODE § 10-2B-8.62 (1975), which states:

“(b) If a director has a conflicting interest respecting a transaction but neither the director nor a related person of the director specified in Section 10-2B-8.60(3)(i) is a party to the transaction such that the director may not make the disclosure described in Section 10-2B-8.60(4)(ii), then disclosure is sufficient for purposes of subsection (a) if the director (1) discloses to the directors voting on the transaction the existence and nature of his or her conflicting interest and informs them of the character and limitations imposed by that duty before their vote on the transaction and (2) plays no part, directly or indirectly, in their deliberations or vote.”

The Company did have the two individuals sign conflict of interest forms for 2005 subsequent to the period under examination in 2009.

CORPORATE RECORDS

The Articles of Incorporation and Bylaws, as amended, were inspected during the course of the examination and found to provide for the operation of the Company in accordance with the usual corporate practice and applicable statutes and regulations.

Minutes of meetings of the Stockholders, Board of Directors and committees of the Company were reviewed for the period under examination. Other than the item previously noted in the caption MANAGEMENT AND CONTROL, the minutes appeared to be complete with regard to recorded actions taken on matters before the respective bodies for deliberation and action.

HOLDING COMPANY AND AFFILIATE MATTERS

Holding Company Registration

The Company is subject to the *Alabama Insurance Holding Company Regulatory Act* as defined in ALA. CODE § 27-29-1 (1975). In connection therewith, the Company is registered with the Alabama Department of Insurance as registrant of an Insurance Holding Company System. The Company is responsible for holding company registration and periodic filings in accordance with ALA. CODE § 27-29-4 (1975), and ALA. ADMIN. CODE 482-1-055 (1994).

Appropriate filings required under the Holding Company Act are made from time to time by the Company as registrant of an Insurance Holding Company System. A review of the Company's filings during the period under review indicated that required disclosures were included in the Company's filings.

Dividends to Stockholders

The following dividends were declared and paid to stockholders of the Company during the period under examination:

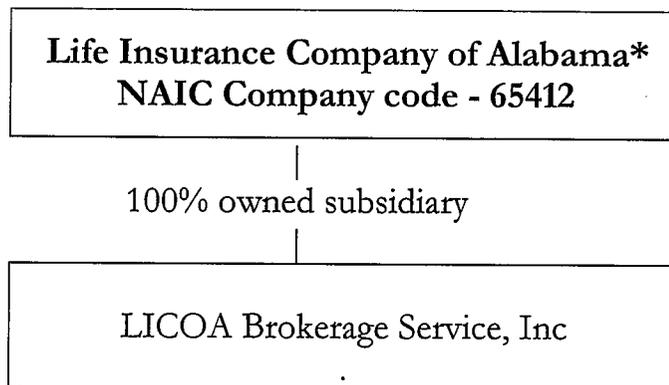
<u>Year</u>	<u>Dividend Paid</u>
2004	\$ 82,022
2005	133,285
2006	133,285
2007	145,488
2008	174,296

The dividends were reported to the Alabama Department of Insurance in accordance with ALA. CODE. § 27-29-4(d)(1975), which states in pertinent part:

“...each registered insurer shall so report all dividends and other distributions to shareholders within five business days following the declaration thereof.”

Organizational Chart

The following chart presents the identities of and interrelationships among all affiliated persons within the Insurance Holding Company System at December 31, 2008:



***Clarence W. Daugette ownership interest:**

Direct:

Common stock - 13.51%

Indirect:

- CBA Partners: Common stock - 1.81%; Class A Common stock 0.69%
- LICOA Investment club: Class A Common stock 0.40%
- Trustee CESTUS Properties LLC: Common stock 31.27%; Class A Common stock 6.14%

Registration Statement of Beneficial Ownership

Effective 9, 2009, the McLaughlin Family LTD Partnership acquired 10.04% ownership of the common share of Life Insurance Company of Alabama; however, the Company did not include McLaughlin Family LTD Partnership's as owners of 10.04% of the common shares of Life Insurance Company of Alabama when filing

the Statement of Beneficial Ownership of Securities at the end of the first quarter 2009. ALA. CODE § 27-29-4(d) (1975), states:

“Amendments to registration statements. Each registered insurer shall keep current the information required to be disclosed in its registration statement by reporting all material changes or additions on amendment forms provided by the commissioner within 15 days after the end of the month in which it learns of each such change or addition, but at least annually, as provided in subsection (a)...”

Transactions and Agreements with Affiliates

The Company has one wholly-owned subsidiary, LICOA Brokerage Services, Inc., which acted as a broker for Life Insurance Company of Alabama in soliciting and receiving applications for life insurance and other kinds of insurance, as well as conducting a general insurance agency in insurance brokerage business.

Life Insurance Company of Alabama and LICOA Brokerage Services, Inc. are parties to a Resource Sharing Agreement, which is an agreement that spells out the relationship between the two companies as well as the sharing of resources between the two companies. The agreement states the responsibilities of each company in the hiring, compensation, supervising, disciplining, and discharging of full-time and part-time employees and agents. The agreement further states the responsibilities of each company in the paying of expenses for office space, utilities, insurance and similar items of facility overhead, furniture and equipment, supplies and miscellaneous goods and services, travel and transportation, and telecommunications.

Life Insurance Company of Alabama and LICOA Brokerage Services, Inc. are also parties to an agreement to share agents. This agreement states that the agents who sell for and represent LICOA Brokerage Service, Inc., may also be licensed agents of and sell for Life Insurance Company of Alabama.

FIDELITY BOND AND OTHER INSURANCE

The Company was covered by a financial institution bond issued by the Fidelity and Deposit Company of Maryland as of December 31, 2008 in an amount which met the suggested minimum amounts of fidelity insurance as required by Exhibit R of the 2008 NAIC Financial Condition Examiners Handbook. The bond provided dishonesty and fraudulent acts coverage committed by any employee of the Company, coverage for loss of property at the home office committed by an employee and also

loss of property in transit resulting from robbery, burglary, misplacement, and common-law or statutory larceny, and also forgery or alteration coverage.

In addition to the above mentioned coverage, the Company was insured under the following insurance policies as of December 31, 2008:

- Financial Institutions Policy covering Property and Contents and also Liabilities of the Company
- Business Automobile Policy
- Commercial Excess and Umbrella Policy including Advertising Injury and Personal Injury Coverage
- Directors, Officers, Insured Entity and Employment Practices Liability Insurance
- Workers' Compensation Policy

The coverages provided under the policies listed were reviewed during the course of the examination, and appeared to be adequate to protect the Company from the risks faced in the normal course of business.

EMPLOYEES' AND AGENTS' WELFARE

Employees' Benefits

The Company provides benefits to the full-time hourly employees and non-exempt salaried employees on a pro-rata share based on the number of hours worked per week, and also provides benefits to the full-time salaried-exempt employees without regard for the number of hours worked per week. The agents of the Company are not employees of the Company, and therefore do not qualify to receive any employee benefits of the Company. The following are the benefits provided to the employees of the Company:

- Paid Holidays
- Vacation Leave
- Sick Leave
- Group Life Insurance
- Group Health Insurance
- Short-term Disability
- Long-term Disability

- Personal Leave
- Leave for Routine Health Care
- Family Leave
- On-the-Job Injury Leave
- Bereavement Leave
- Jury Duty Leave
- Uniformed Services Leave
- 401(k) Retirement Plan
- Section 125 Cafeteria Plan

Section 1033 of Title 18 of the U.S. CODE

Under ALA. ADMIN. CODE 482-1-121 (2003), the Company is required to comply with the Violent Crime Control and Law Enforcement Act of 1994, US Code, Title 18, Section 1033 (e)(1)(A), which prohibits individuals who have been convicted of any criminal felony involving dishonesty, breach of trust or a violation of this Act from engaging in the business of insurance in interstate commerce without the specific written consent from the Commissioner of Insurance. The Company requires all applicants for employment and current employees to annually sign a Violent Crime Control and Law Enforcement Act of 1994 form, which states that they have not been convicted of a felony. Accordingly, the Company was in compliance with ALA. ADMIN. CODE 482-1-121 (2003).

Effective July 1, 2009, the Company is required to provide evidence that it has an internal policy and procedure in place, by means of background checks, to ensure those with whom it intends to contract to do business of insurance is in compliance with Section 1033 of Title 18 of the U.S. CODE and ALA. ADMIN. CODE 482-1-146.11 (2009), which states:

“Responsibilities of Section 1033 Insurers.

(1) A Section 1033 insurer subject to the Commissioner’s examination authority shall have and apply the following:

(a) An internal procedure for determining, by means of background checks or investigations or otherwise, whether applicants for employment or individuals with whom the insurer intends to contract for activities in the business of insurance, whether or not in a capacity requiring a license, have a felony conviction for a Section 1033 offense.

(b) An internal procedure after initial employment or contracting, applied on a periodic basis, to ascertain the existence of a felony conviction for a Section 1033 offense.

(c) An internal procedure for assuring that affected employees or individual contractors have obtained and hold any required Section 1033 consent during the period of employment or contracting.

(2) Such procedures shall be maintained in a format capable of being furnished to the Department as part of the examination process or otherwise as requested by the Department.

(3) As part of an examination or otherwise, the Department may determine the existence of such procedures, whether and how they are being followed, and the effectiveness of the procedures.”

SPECIAL DEPOSITS

The Company had the following securities on deposit with state authorities as of December 31, 2008 in order to satisfy the statutory deposit requirements of the various states in which the Company writes business:

<u>State</u>	<u>Par Value</u>	<u>Statement Value</u>	<u>Fair Value</u>
Alabama *	\$ 1,200,000	\$ 1,196,786	\$ 1,200,508
Arkansas	200,000	72,000	72,000
Florida	400,000	399,732	334,368
Georgia	110,000	110,333	122,109
Louisiana	25,000	25,000	25,000
Oklahoma	300,000	303,914	320,601
South Carolina	500,000	508,206	569,094
TOTALS	\$ 2,735,000	\$ 2,615,971	\$ 2,643,680

*Held for the protection of all policyholders.

The deposits were confirmed through the use of the custodial confirmations obtained directly by the examiners or obtained by the external auditors of the Company.

The *Schedule E – Part 3 – Special Deposit* of the 2008 Annual Statement listed the statutory deposits held by various states, listed in the table above, under columns 3 and 4, indicating that the deposits were held for the benefit of all policyholders. The examiners determined that the deposit held by the State of Alabama was held for the benefit of all policyholders and appropriately reported under columns 3 and 4. The deposits held by six other states were for the benefit of all policyholders in the respective states and should have been reported under columns 5 and 6, in accordance with the guidance provided by the NAIC Annual Statement Instructions, which states:

“Columns 5 and 6 - All other Special Deposits - Report any deposits not included in Column 3 and 4 which are held for any special or statutory purpose.”

It was also determined that the security held under statutory deposit with the Arkansas Department of Insurance with a par value of \$200,000 had a market value of \$72,000. This value was below the required market value of \$100,000 required by Ark. Code Ann. § 23-63-206, which states:

“(a) All insurers authorized to transact insurance in this state shall make and maintain a deposit of securities as follows:

(1)(A)(i) All insurers authorized to transact only life or accident and health insurance, or both, shall deposit through the Insurance Commissioner and subject to the conditions specified in § 23-63-909 securities eligible for deposit under § 23-63-903 and having at all times a market value of not less than one hundred thousand dollars (\$100,000), conditioned for the payment of policyholders and creditors of the insurer in this state and the prompt payment of all claims arising and accruing to any person in this state.”

MARKET CONDUCT ACTIVITIES

Territory

As of December 31, 2008, the Company was licensed to transact business in the following eleven states:

Alabama	Kentucky	Oklahoma
Arkansas	Louisiana	South Carolina
Florida	Mississippi	Tennessee
Georgia	North Carolina	

The certificates of authority issued by the respective states were inspected for the period under review and found to be in order. There were no pending applications at December 31, 2008.

Plan of Operation

The Company markets and acquires business through the worksite market where the target demographic is the professional blue collar worker. The Company specializes in selling supplemental Health, Accident and Disability insurance and small individual Life policies in Voluntary Payroll Deduction groups. These products are marketed to both small and large employers in the State. The target area for distribution includes groups in rural and urban areas with populations less than 75,000. Life Insurance Company of Alabama agents are not employees of the Company; however, a certain number sell exclusively for the Company. The field force consists of personal producing General Agents who may do one or more of the following: sell, specialize in recruiting and agency building, or may perform both functions selling and recruiting.

The Company expects its future sales growth will increase from better saturation of the current territory and some expansion into other states. The Company's long-term goal is to increase their new life premium production to 25% of the new premium produced, which is 5% over previous years. They intend to utilize Regional Directors and General Agents to help facilitate the Company's efforts with agency recruiting and continued training for existing agents. It is management's expectation that commissioned Regional Directors will continue to assist agents and more will be appointed to work specific regions; however, there will no longer be exclusive territories for the Directors. Agents continually meeting sales goals will maintain the longevity of the Company.

Underwriting, Policy Forms and Rating Practices

The Company uses the *Reinsurance Life Underwriting Manual*, a published guide which provided rating based upon a numerical method of risk classifications. The medical information in the manual was appropriate for assessing an applicant's risk based upon specific medical condition(s). The Manual did not evidence any discriminatory guidance for underwriters in the risk selection process.

Policy Forms

During the review of the Company's annual actuarial certifications for policy illustrations to the ALDOI for the period under review, it was noted that the Company did not have any filings from the effective date of the Regulation 114 (1998) until the time of its first filing which was in 2007. At the time Regulation 114 became effective the Company was still marketing and selling Universal Life policies;

as a result, annual certifications to the ALDOI for these policies should have been filed.

From 1998 to 2006 the Company did not appropriately file with the ALDOI annual actuarial certification for policies that were to be marketed with or without an illustration in accordance with the requirements of ALA. ADMIN. CODE 482-1-114-.05 (A) (1998), which states:

“Each insurer marketing policies to which this chapter is applicable shall notify the commissioner whether a policy form is to be marketed with or without an illustration. For all policy forms being actively marketed on the effective date of this chapter, the insurer shall identify in writing those forms and whether or not an illustration will be used with them. For policy forms filed after the effective date of this chapter, the identification shall be made at the time of filing. Any previous identification may be changed by notice to the commissioner.”

During the review of the policy illustrations annual actuarial certifications filed with the ALDOI, it was noted that Mr. Steven Keck, FSA, MAAA, certified for 2007 - 2010 that policy forms: 2004 LT220 Term Life Insurance and 2004 WL 142 Whole Life were policy forms that were to be marketed without illustrations. The Company identified its 20 Year Term (Term) and the Protector II (Whole Life) policies as policy forms to be marketed without an illustration. However, in spite of the illustration actuary notifying the Department that these forms were not to be illustrated, the Company did actually provide illustrations on the Term and Whole Life insurance policies at the time of issue. ALA. ADMIN. CODE 482-1-114-.05 (B) (1998) states:

“If the insurer identifies a policy form as one to be marketed without an illustration, any use of an illustration for any policy using that form prior to the first policy anniversary is prohibited.”

Thus the Company did not comply with the requirements of ALA. ADMIN. CODE 482-1-114-.05 (B) (1998) by providing an illustration during the first policy year.

Rate Filings

The Company properly utilized the rates filed and approved by the Alabama Department of Insurance for the examination period under review. Rate filings were submitted to the the Alabama Department of Insurance and the Company did not implement the rates calculated until the proper approval was received. Electronic and manual rate tables were utilized by agents on the basis of the underwriting criteria of a

consumer to calculate the policy premium. Inspection Reports and information obtained from the Medical Information Bureau (MIB) was not used as the sole basis for the Company's underwriting standards.

Life

The Company wrote life coverage in a variety of forms within the basic classifications of Whole Life (Smoker and Non-smoker) and 20 Year Term. The Company has a \$100,000 retention limit regardless of age, rating or type of life policy. Policies are reinsured up to \$200,000 on an automatic basis. For policy coverage limits over \$200,000 are reinsured on the facultative basis of the reinsurer's underwriting decision. For Accidental Death Benefit, coverage is automatically reinsured on a bulk basis except for amounts over \$100,000. For ADB, coverage over \$100,000 is reinsured on a facultative basis of the reinsurer's underwriting decision.

Accident and Health

The Company offers Cancer, Accident and Health, Intensive Care and Disability Income coverages on an individual basis collected by direct billing or through payroll deduction. Each type of policy provided benefit schedules for specific treatment, care or hospital charges due to specific losses or cancer. The Company's Group Accident plans are group rated for full-time employees that are offered the benefit of payroll deduction. Disability and Hospital Indemnity plans are payroll deduction only plans and are underwritten based on height, weight, and medical history.

Advertising and Marketing

The Company's advertising and marketing strategy was executed through the distribution of printed solicitation materials utilized by agents and the Company's website. The website provided product information and product descriptions of Life insurance and Accident & Health plans offered by the Company. Marketing materials are provided to agents for soliciting prospective clients and to counsel clients during the sale of products. Agents are allowed to advertise on the internet but only with the permission of the Company. Agents are required to submit an advertising form prior to establishing an active website. The advertising form, which details information about the agent's website, must be submitted annually to the Company's Home Office Agency/Marketing Department.

The Company markets and acquires business through the worksite market. The Company specialized in selling supplemental Health, Accident and Disability

insurance and small individual Life policies. These products are marketed to both small and large employers in the states in which they are licensed.

The Company discontinued five of its old life products in 2005 and introduced two new life products: Protector II Whole Life and 20 Year Guaranteed Level Term. A long term goal of the Company is to increase the new life premium production to 25% of new premium produced. In the first quarter of 2009, the Company started marketing a new "indemnity only" cancer policy.

LICOA offers Ordinary Life Insurance (Whole & Term life), Accident & Health, Supplemental Insurance (Cancer Indemnity, Short Term Disability (STD), Group Dental, Intensive Care and Hospital Indemnity, and Heart/Stroke Expense Plan) and the convenience of payroll deduction premium payments. As of December 31, 2008, the Company's products are sold and serviced by 1,123 General Agents and seven Regional Directors that are not employees of Life Insurance Company of Alabama. The Regional Directors recruit only for LICOA and their regions consist of one or two states. The Company markets its products in eleven states in the Southeastern and Midwestern zones, which include: Alabama, Arkansas, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, Oklahoma, South Carolina, and Tennessee.

Claims Payment Practices

Samples of paid, open, closed and closed-without-payment claim files were reviewed in order to evaluate the Company's compliance with policy provisions, timeliness of payment, adequacy of documentation and file retention requirements. During the sample review of Life and A&H claims paid, it was noted that the Company did not maintain copies of 34 canceled Life and Accident and Health checks from the sample of 109 in its records at the home office. The Company later provided copies of the canceled checks which were obtained from Regions Bank. Canceled claim checks should be maintained in the Company's records at its home office in accordance with the requirements of ALA. CODE 27-27-29 (a) (1975), which states:

"Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds of insurance transacted."

Policyholders' Complaints

For the period under review, there were nineteen complaints filed with the Alabama Department of Insurance. There was one complaint where the Company did not respond to the ALDOI within ten days in accordance with the requirements of ALA. ADMIN. CODE 482-1-118-.06 (1999), which states:

“The insurer shall provide, within ten (10) working days, any record or response requested in writing by any duly appointed deputy, assistant, employee or examiner of the Commissioner. When the requested record or response is not produced or cannot be produced by the insurer within ten working days, the nonproduction shall be deemed a violation of this rule, unless the Commissioner or duly appointed person making the request grants an extension in writing or the insurer can demonstrate to the satisfaction of the Commissioner that there is a reasonable justification for the delay.”

The ALDOI notified the Company of the policyholder complaint in a letter dated October 21, 2008. The Company responded to the ALDOI Consumer Services Specialist in a letter dated December 9, 2008. The Company response time to the ALDOI was 36 days. From a review of the complaint file documentation, the Company did not request an extension and did not provide an explanation as to the reason for the delay in responding.

The complaint file documentation was reviewed and it was determined that the files contained appropriate documentation. The files evidenced the following information:

- The Company does have appropriate procedures in place to handle complaints received as well as internal procedures for analysis in areas of developing complaints;
- The Company does have appropriate procedures for a method of distribution of and obtaining and recording response's to complaints;
- The Company's responses were complete and addressed all the concerns and issues raised in the complaint;
- The documentation included in the complaint files was appropriate and adequate to document the Company's position regarding the complaint; and
- The appropriate remedies for consumers were identified.

Compliance with Agents' Licensing Requirements

Terminated Agent Reconciliation

The Department's listing included 276 terminated/cancelled agents. A reconciliation of the Department's listing to the Company's listing was performed. During this reconciliation, it was determined that there were 141 terminated/cancelled agents that were recorded in the Department's listing that were not recorded in the Company's listing.

The Company did not appropriately document terminated/cancelled agents in its listing of agents that was provided to the examiners to review and perform the reconciliation of agents. The Company should maintain a complete and accurate listing of its agents and comply with ALA. CODE 27-27-29 (a) (1975), which states:

“(a) Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

The Company's Executive Administrative Assistant explained: “In the past few years Life Insurance Company of Alabama has printed a listing from the Alabama Insurance Department website of licensed agents for the year. We have used that listing and determined those to be renewed and those to be cancelled for the coming year. Licenses were cancelled through the Alabama Insurance Department website and NIPR. Beginning this year, I have cancelled licenses individually thru Cratchit-net and printed each individual cancellation notice for the Alabama Insurance Department and for each agents personnel file. This should be a more accurate accounting of licensed agent's each year.”

Appointed Agent Reconciliation

During the reconciliation of the Company's 2004 to 2008 appointed agents listing to the ALDOI listing, it was noted that there were 115 agents listed as appointed by the ALDOI. The Company did not appropriately update its appointed agents' listing that was provided to the examiners to review and perform the reconciliation of agents to the listing maintained by the ALDOI. The Company should maintain a complete and accurate listing of appointed agents, and comply with ALA. CODE 27-27-29 (a) (1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

Maintaining Producer Licensing Records

The Company should accurately maintain and update its agents' listings on a regular basis in order that the number of terminated, canceled, and appointed agents can be readily determined in accordance with ALA. CODE 27-27-29 (a) (1975), which states:

“(a) Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, or insurance transacted.”

Policyholders Services

A sample of 113 reinstated policies was reviewed in order to verify that reinstatement provisions were applied consistently and in a non-discriminatory manner and to determine if reinstatement notices were sent out on a timely basis. From this review, it was determined that policies were reinstated within thirty days and were reinstated in accordance with the Company's reinstatement procedures and policy provisions.

Dividends to Policyholders

The Company paid policyholder dividends during the five-year period covered by the examination. The filed Annual Statement reflects the following payments:

<u>Year</u>	<u>Amount Paid</u>
2004	\$ 15,996
2005	20,078
2006	19,902
2007	18,824
2008	17,782

Privacy Policy and Practices

The Company has implemented a mandatory compliance training program for: “Sensitive Information Policy and Identity Theft Prevention Program.” From a

review of the Company's Prevention Program, it was determined that the Company has appropriate procedures for identifying "red flags" for potentially fraudulent activity within new or existing covered accounts. All staff employees and contractors receive training on the Company's privacy provisions and Health Insurance Portability and Accountability Act (HIPAA's) privacy requirement. New employees are trained in the employee orientation program. Any material change in the Company's policy will result in all affected employees being re-trained according to the new privacy provisions prior to or within a reasonable time following the effective date of the change. All employees are required to sign a confidentiality agreement acknowledging receipt of the Company's privacy policies and procedures, certifying completion of training, and agreement to abide by the provisions of the policies and HIPAA privacy requirements.

The Company's Privacy Policy does not allow for an-opt out provision. There is not an-opt out provision because the Company does not disclose any personal financial or health information to any affiliated or nonaffiliated third parties. The Company only disclosed information permitted by law such as: disclosures to organizations that provide claims administration, underwriting, investigation or policyholder services for the Company on its behalf. Any financial information that the Company obtains about its policyholders were in accordance with the Fair Credit Report Act. The information obtained consisted of: credit history, income, assets, type and value of other insurance products the policyholder owns or applied for, and the amount of insurance premiums paid by the policyholder to other insurance companies.

The Company issues a Privacy Notice to all customers prior to establishing an on-going relationship, new customers receive the Notice after the policy is issued and every year thereafter, and existing policyholder's received a Notice annually as well. The Company policies and procedures for providing customers with the initial and annual Privacy Notice complied with the requirements of ALA. ADMIN. CODE 482-1-122-.05 & -.06 (2001), which states:

"A. Initial notice requirement. A licensee shall provide a clear and conspicuous notice that accurately reflects its privacy policies and practices to both of the following: (1) Customer. An individual who becomes the licensee's customer, not later than when the licensee establishes a customer relationship.... (2) Consumer. A consumer, before the licensee discloses any nonpublic personal financial information about the consumer to any nonaffiliated third party, if the licensee makes a disclosure other than as authorized by Sections 15 & 16." "A. (1) General rule, A licensee shall provide a clear and conspicuous notice to customers that accurately reflects its privacy policies and practices not less than annually during the continuation of the customer relationship.

Annually means at least once in any period of twelve (12) consecutive months during which that relationship exists. A licensee may define the twelve-consecutive-month period, but the licensee shall apply it to the customer on a consistent basis.”

The last edition date of the Company Privacy Notice was June 2008. The Company does not issue simplified, Short Form Notices, and does not have joint marketing and servicing agreements with any nonaffiliated third parties

The Company established that it makes reasonable efforts to disclose only the minimum necessary information, trains its employees on the importance of protecting policyholders PHI, has mechanisms in place to ensure integrity of data during transmission, and the Company has a strict policy for its employees and vendors for violations of its HIPAA policies and procedures.

The Company had a mandatory policy which required that all employees received appropriate Privacy training and must sign an Employee Confidentiality Agreement (ECA). Company management explained that four employees had not signed the ECA, hence the Company did not comply with its own Privacy policies and procedures.

FINANCIAL CONDITION/GROWTH OF THE COMPANY

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital and Surplus</u>	<u>Premiums Earned</u>
2008*	\$ 81,158,532	\$ 65,664,431	\$ 15,494,101	\$ 39,223,189
2007	79,199,132	62,566,738	16,632,394	37,247,468
2006	73,821,560	59,379,008	14,442,552	36,428,537
2005	68,903,099	56,622,427	12,280,672	34,949,260
2004	64,840,370	53,900,117	10,940,253	33,261,334
2003*	60,830,079	52,182,202	8,647,877	31,294,522

*Per examination. Amounts for the remaining years were obtained from Company copies of filed Annual Statements.

MORTALITY AND LOSS EXPERIENCE

The information was obtained from the Company’s filed Annual Statements for 2004, 2005, 2006, 2007 and 2008.

Life Insurance

<u>Year</u>	<u>Tabular Cost</u>	<u>Contract Benefits</u>	<u>Reserves Released By Death and Other Terminations</u>
2004	\$ 3,135,654	\$ 1,670,680	\$ 667,172
2005	2,770,581	2,104,704	883,905
2006	3,361,221	1,990,881	770,035
2007	3,416,303	1,996,965	742,842
2008	3,674,688	1,959,295	920,178

It should be noted that the tabular cost plus reserves released by death and other terminations was greater than the contract benefits, which implies that the mortality costs built into the reserves were more than sufficient to cover the contract benefits of the Company.

Accident and Health Insurance

<u>Year</u>	<u>Earned Premiums</u>	<u>Incurred Claims</u>	<u>Net Gain From Operations</u>
2004	29,135,127	15,664,712	1,587,979
2005	30,294,429	16,353,202	1,745,117
2006	32,057,908	17,256,535	1,808,709
2007	32,832,968	17,132,183	1,914,654
2008	34,173,584	17,536,304	1,553,505

The incurred claims divided by earned premiums for 2004 was 53.8%, for 2005 was 54.0%, for 2006 was 53.8%, for 2007 was 52.2% and for 2008 was 51.3%. The net gain from operations shows that after investment income is added and all expenses and taxes are deducted the Company still had a positive result.

REINSURANCE

Reinsurance Assumed

Schedule S - Part 1 - Section 1 of the Company's 2008 Annual Statement indicated that the Company assumed reinsurance under the Servicemen's Group Life Insurance (SGLI), and Federal Employees Group Life Insurance (FEGLI) pooling arrangements. Participating in these government insurance pools provides little or no financial rewards. Participation in these pooling arrangements does not require that the Company establish any reserves to cover the business reinsured.

Metropolitan Life Insurance Company: The Yearly Renewal Term - Group contract was effective October 1, 1979 and will continue until terminated. The FEGLI pooling arrangement contributed \$500 in assumed premiums during 2008 and the insurance in-force was \$1,158,564. The agreement had standard insolvency language without cut-through provisions.

Prudential Insurance Company of America: The Yearly Renewal Term - Group contract was effective September 29, 1965 and will continue until terminated. The SGLI pooling arrangement contributed \$2,570 in assumed premiums during 2008 and the insurance in-force was \$1,039,089,503. The agreement had standard insolvency language without cut-through provisions.

Reinsurance Ceded

The Company's ceded reinsurance program consisted of automatic coinsurance and yearly renewable term reinsurance agreements with option to negotiate facultative reinsurance over the reinsurer's maximum limits. *Schedule S - Part 3 - Section 1* indicated that the reserve credit taken in 2008 under the Life reinsurance agreements was \$1,071,447, and *Schedule S - Part 3 - Section 2* indicated that the reserve credit taken in 2008 under Accident and Health reinsurance agreement was \$3,268. The significant reinsurance agreements in-force were with the following reinsurers: 1) Scottish Re. Life Corporation, 2) Swiss Re Life & Health America as of December 20, 2001, was formerly Lincoln National Life Insurance Company, 3) Optimum Re., and 4) Hannover Life Reassurance Company of America negotiated during the current examination. The reinsurance agreements with the four reinsurers are summarized below:

Swiss Re

Treaty	None
Type	Yearly renewable term automatic reinsurance /Facultative
Coverage	1) Ordinary life, 2) Waiver of premium disability, & 3) Accidental death
Effective	July 7, 1971
Retention	<u>Amendment # 5 - Effective January 1, 1980</u> <u>Ages 0-60:</u> Standard - \$40,000; Tables A - B retention is \$10,000; Tables C - D retention is \$5,000; and Table E - P retention is \$2,000. <u>Ages 61:</u> Standard - \$10,000; Tables A - B retention is \$5,000; Tables C - D retention is \$2,500; and Table E - P retention None.
Reinsure's limit	<u>Ages 0-60:</u> Standard -\$200,000; Tables A - B \$50,000; Tables C - D \$25,000; Table E - P \$10,000 <u>Ages 61 - 65:</u> Standard - \$50,000; Tables A - B \$25,000; Table C - D \$12,500.
Amendment	Several amendments included in the reinsurance contract.
Insolvency	Standard insolvency language without cut-through provision

Swiss Re

Treaty	64434071
Type	Coinsurance
Coverage	Whole Life 140/141
Effective	July 7, 1971
Retention	\$50,000.
Reinsure's limit	\$100,000
Amendment	January 1, 1980 – Added bulk ADB
Insolvency	Standard insolvency language without cut-through provision

Optimum Re

Treaty	261 – 07AY17
Type	Yearly renewable term automatic reinsurance /Facultative
Coverage	<u>Alphabet A – Z</u> Whole Life (2004 –WL142) Term (2004 –LT220)
Effective	September 1, 2007
Retention	\$100,000 per life
Reinsurers Limits	2 times the Company's retention to a maximum of \$200,000 in excess of the Company's retention. Facultative reinsurance \$4,000,000 per life. Jumbo limit of \$4,000,000.
Amendment	Several amendments included in the reinsurance contract.
Insolvency	Standard insolvency language without cut-through provision.

Optimum Re

Treaty	781
Type	Coinsurance
Coverage	<u>Alphabet L – Z</u> 10 years term
Effective	July 1, 1991 (Amendment) August 1, 2006 (Amendment)
Retention	<u>Ages 0 – 60:</u> Standard thru table 2 - \$50,000; Table 3 thru table 6 - \$25,000; Table 8 through up, \$10,000. <u>Ages 61 and over:</u> Standard thru table 2 - \$25,000; Table 3 thru table 6 - \$10,000; Table 8 through up, \$5,000. Waiver of premiums – Same as life
Reinsurers Limits	400% of ceding Company's retention.
Amendment	Effective august 1, 2006, the coverage include alphabet A – Z.
Insolvency	Standard insolvency language without cut-through provision.

Scottish Re

Treaty	1394 (Phoenix Mutual), ERC
Type	Coinsurance
Coverage	Alphabet A – K 10 years term
Effective	March 1, 1992
Retention	Ages 0 – 60: Standard thru table 2 - \$50,000; Table 3 thru table 6 - \$25,000; Table 8 through up, \$10,000. Ages 61 and over: Standard thru table 2 - \$25,000; Table 3 thru table 6 - \$10,000; Table 8 through up, \$5,000 Waiver of premiums. Corridor: \$10,000 for all ages and ratings.
Reinsurers Limits	Nine times the ceding Company's retention or \$450,000, whichever is less
Amendment	Effective August 1, 2006, the parties agreed to no longer accept new business.
Insolvency	Standard insolvency language without cut-through provision.

Hannover Life

Treaty	HA-LIAL-01
Type	Yearly renewable term automatic reinsurance
Coverage	Whole Life (2004 –WL142) Term (2004 –LT220)
Effective	April 1, 2005
Retention	\$100,000 per life
Reinsurers Limits	\$1,000,000, per life. Excess Quota Share – 100% over the Company's maximum retention.
Amendment	Effective August 31, 2007, the parties to the agreement agreed to no longer accept new business.
Insolvency	Standard insolvency language without cut-through provision.

ACCOUNTS AND RECORDS

The Company's accounting records were maintained on electronic data processing equipment and manually on personal computers. The Company shares some of the management resources with LICOA Brokerage Service, a 100% owned subsidiary of the Company, under a Resource Sharing Agreement. For further review of the agreement, see the caption HOLDING COMPANY AND AFFILIATES section of this report.

External Audit and Actuarial services

The Company was audited annually by the certified public accounting firm of Barfield, Murphy, Shank & Smith PC, Birmingham, Alabama. Mr. Jack Knight, CPA

was the engagement partner as of December 31, 2008. The audit reports and workpapers of the external auditors were made available to the examiners and were utilized as deemed appropriate.

The examiners requested the awareness letter from Barfield, Murphy, Shank and Smith PC (BMSS) independent auditor. BMSS indicated that an awareness letter was not issued to the Company, which was not in compliance with, ALA. ADMIN. CODE 482-1-100-.06 (2004), which states:

“(2) The insurer shall obtain a letter from the accountant, and file a copy with the Commissioner stating that the accountant is aware of the provisions of the insurance code and the rules and regulations of the insurance department of the state of domicile that relate to accounting and financial matters and affirming that the accountant will express his or her opinion on the financial statements in terms of their conformity to the statutory accounting practices prescribed or otherwise permitted by that insurance department, specifying such exceptions as he or she may believe appropriate.”

The Company’s reserves were certified by Mr. John Kidder, FSA, MAAA, during 2004 and Mr. Steven Keck, FSA, MAAA, during 2005 – 2008, both with the firm of Wakely Actuarial Services Inc., Palm Harbor, FL.

Unclaimed property filings

In a review of the Report of Unclaimed Property filed with the State Treasurer of Alabama for the years of 2004 through 2008, the examiner determined that the Company was reporting escheatable funds that were three years or older as of December 31 of the year prior to the year in which the report was filed, instead of reporting escheatable funds that were three years or older as of June 30 of the same year in which the report was filed. This was not in compliance with ALA. CODE § 35-12-76(c) (2004), which states:

“The report shall be filed before November 1 of each year and cover the 12 months next preceding July 1 of that year.”

Record Retention Policy

The Company did not have a formal written record retention policy and related procedures. The Company’s Board of Directors should develop a record retention policy and procedure that fits its business needs and at the minimum ensure compliance with ALA. ADMIN. CODE 482-1-118-.03 (1999), which states:

“Every insurer, which term shall include every domestic insurer, foreign insurer, health care services corporation, health maintenance organization, prepaid dental plan, managing general agent or any other legal entity regulated by the Insurance Code and licensed to do business in this state shall maintain its books, records, documents and other business records in order that the insurer’s financial condition may be readily ascertained by the Department of Insurance, taking into consideration other record retention requirements. All records must be maintained for not less than five (5) years.”

Disaster Recovery Plan & Information System Controls

The Company had not tested its disaster recovery plan. Testing a disaster recovery plan identifies areas where a plan may be improved upon and increases the probability of recovering and resuming operations efficiently.

The Company’s off-site storage area was in a warehouse that was not climate controlled. Seasonal variations in temperature and humidity can adversely affect the data stored at the site and could render it unrecoverable. Damaged recovery/backup tapes significantly increases the risk the Company will not be able to efficiently recover from an adverse event.

During an examination of the Company’s Information Systems, the controls governing disaster recovery were reviewed. It was determined the recovery site and tape storage building were both located within one-half mile of the Company. The concentration of all of the Company’s records and back-up data within such an area increases the risk of permanent data loss from a localized adverse event, such as a tornado. The data loss could result in Company failure.

During an examination of the Company’s Information Systems, the controls governing system level security were reviewed. It was determined the parameters for password aging and history were not activated. The constant use of the same passwords increases the risk of password compromise and subsequent unauthorized access. Best business practices require system level access software to be set so that users are required to change their passwords at least quarterly. There should also be a password history file that is used to prevent the reuse of passwords.

Consideration of Fraud

The examiner utilized Exhibit G – Consideration of Fraud from the NAIC Financial Condition Examiners Handbook, to identify fraud risk factors and obtain a reasonable

assurance that the financial statements were free from material misstatement due to fraud. The CPA's documentation, as required by Statement of Auditing Standard (SAS) No. 99 *Consideration of Fraud in a Financial Statement Audit*, was reviewed and procedures were added to test the fraud risk factors in the Risk Assessment Matrix.

Company management was interviewed to understand corporate governance, and its commitment to ethics, risk management and knowledge of fraud risk factors. Company management indicated that they had not identified any fraudulent activities perpetrated within or against the Company.

Reporting Fraudulent Insurance Acts to the Commissioner

The Company's employees' handbook requires employees to report violation of the code of ethics to the internal auditor, the president or a member of the Board of Directors through an anonymous hotline service by telephone or by submitting a written report via internet e-mail. The Company did not have written procedures for the prevention, detection, and elimination of fraud. The Company should establish procedures for the prevention, detection, and elimination of fraud and the procedures should include the reporting of fraudulent insurance acts to the commissioner of insurance, which meet the requirements of ALA. ADMIN. CODE 481-1-054-.03(1) (2003), which states:

“(1) The Commissioner of Insurance shall be notified within thirty days of the happening of any one or more of the following:

- (a) The suspension or revocation of a licensee's license, certificate of authority, or right to transact business in another state....
- (e) The filing of a civil lawsuit, the rendering of a verdict, or the finding of a court against a producer, where such lawsuit, verdict, or finding of a court alleges or charges the producer with committing any of the following acts in the State of Alabama: intentional misrepresentation, fraud, dishonesty, misappropriation or conversion of funds, a breach of a fiduciary duty, or any other offense involving a breach of trust....

(2) The notice required in this rule shall be provided by the licensee directly involved in any such event.”

FINANCIAL STATEMENTS

Financial statements included in this report, which reflect the financial condition of the Company at December 31, 2008, and its operations for the years under examination, consist of the following:

	<u>Page</u>
Statement of Assets, Liabilities, Capital and Surplus	33 and 34
Statement of Revenue and Expenses	35
Statement of Reconciliation of Capital and Surplus	36

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN THIS REPORT ARE AN INTEGRAL PART THEREOF.

LIFE INSURANCE COMPANY OF ALABAMA
STATEMENT OF ASSETS
For the Year Ended December 31, 2008

	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
ASSETS			
Bonds (Note 1)	\$ 67,892,448		\$ 67,892,448
Stocks:			
Preferred stocks	163,806	\$ 656	163,150
Common stocks	1,133,856		1,133,856
Real estate:			
Properties occupied by the company	387,220	1,450	385,770
Properties held for the production of income	180,166	37,209	142,957
Cash (\$94,073), Sch. E-Part 1), cash equivalents and short-term investments(\$870,000, Sch. DA) (Note 2)	775,927		775,927
Contract loans	2,720,029	-0-	2,720,029
Other invested assets (Schedule BA)	2,693,844		2,693,844
Receivable for securities (Note 3)	<u>364,428</u>	<u>364,428</u>	<u>-0-</u>
Subtotals, cash and invested assets	<u>\$ 76,311,724</u>	<u>\$ 403,743</u>	<u>\$ 75,907,981</u>
Investment income due and accrued	\$ 1,078,167		\$ 1,078,167
Premiums and considerations:			
Uncollected premiums and agents' balances in course of collection (Note 4)	1,267,509	788,310	479,199
Deferred premiums, agents' balances & installments booked but deferred and not yet due (Note 5)	2,067,917		2,067,917
Other amounts receivable under reinsurance contract	475,500		475,500
Current federal and foreign income tax recoverable and interest thereon	16,733		16,733
Net deferred tax asset	3,086,340	2,673,017	413,323
Electronic data processing equipment and software	51,445		51,445
Furniture and equipments, including health care delivery assets	30,553	30,553	
Aggregate write-ins for other than invested assets:			
Cash surrender value for life insurance	668,267		668,267
Prepaid insurance premiums	45,697	45,697	
TOTALS	<u>\$ 85,099,852</u>	<u>\$ 3,941,320</u>	<u>\$ 81,158,532</u>

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN THIS REPORT ARE AN INTEGRAL PART THEREOF.

LIFE INSURANCE COMPANY OF ALABAMA
STATEMENT OF LIABILITIES, CAPITAL AND SURPLUS
For the Year Ended December 31, 2008

LIABILITIES	
Aggregate reserve for life contracts (Note 6)	\$ 33,013,740
Aggregate reserve for accident and health contracts (Note 6)	20,390,500
Liability for deposit-type contracts	1,529,348
Contract claims:	
Life (Note 7)	514,149
Accident and health (Note 7)	7,058,228
Dividends apportioned for payment	18,414
Coupons and similar benefits	6,050
Premiums and annuity considerations for life and accident and health contracts received in advance (Note 8)	475,936
Contract liabilities not included elsewhere:	
Other amount payable on reinsurance	3,985
Interest Maintenance Reserve	156,984
Commissions to agents due or accrued-life contract (Note 9)	163,311
General expenses due or accrued (Note 10)	1,008,469
Taxes, licenses and fees due or accrued, excluding federal income taxes	174,390
Current federal and foreign income taxes	78,333
Unearned investment income	751,506
Amounts withheld or retained by company as agent or trustee	102,599
Amount held for agents' account	3,798
Remittances and items not allocated	166,415
Miscellaneous liabilities:	
Asset valuation reserve	48,276
Total Liabilities	<u>\$ 65,664,431</u>
CAPITAL AND SURPLUS	
Common capital stock	\$ 1,500,000
Gross paid in and contributed surplus	1,773,659
Unassigned funds (surplus) (Note 11)	12,947,784
Less treasury stock, at cost	
Common stock valued at	<u>727,342</u>
Total Surplus	<u>\$ 13,994,101</u>
Total Capital and Surplus	\$ 15,494,101
TOTAL LIABILITIES, CAPITAL AND SURPLUS	<u>\$ 81,158,532</u>

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN
THIS REPORT ARE AN INTEGRAL PART THEREOF.

LIFE INSURANCE COMPANY OF ALABAMA
STATEMENT OF REVENUE AND EXPENSES
For the Years Ended December 31, 2008, 2007, 2006, 2005, and 2004

Income	2008	2007	2006	2005	2004
Premiums and annuity consideration	\$39,223,189	\$37,247,468	\$36,428,537	\$34,949,260	\$33,261,334
Considerations for supplementary contracts with life contingencies		29,529			
Net investment income	4,253,884	4,067,430	3,790,813	3,507,086	3,271,689
Amortization of IMR	13,121	946	(7,452)	7,642	(36,779)
Aggregate write-ins for miscellaneous income	600,668	52,856	46,565	106,588	142,468
Total Income	\$44,090,862	\$41,398,229	\$ 40,258,463	\$ 38,570,576	\$ 36,638,712
Deductions:					
Death benefits	\$1,959,295	\$2,002,965	\$1,995,881	\$2,112,242	\$1,672,680
Annuity benefits	247,121	284,836	309,904	277,980	201,297
Disability benefits and benefits under accident and health contracts	17,561,469	17,104,971	17,207,166	16,315,827	15,554,525
Coupons, guaranteed annual pure endowments and similar benefits	4,950	12,765	13,454	13,349	24,796
Surrender benefits and withdrawals for life contracts	778,064	594,885	619,990	717,499	528,382
Interest and adjustments on contract or deposit-type contract funds	1,555	1,539	1,555	2,168	1,876
Payments on supplementary contracts with life contingencies	662	568	568	568	568
Increase in aggregate reserves for life and accident and health contracts	3,059,983	2,359,364	1,948,081	1,824,326	1,830,528
Totals	\$23,613,099	\$22,361,893	\$22,096,599	\$21,263,959	\$19,814,652
Commissions on premiums, annuity considerations & deposit-type contract funds	8,639,090	8,177,366	8,051,846	7,672,909	7,742,529
General insurance expenses	7,751,124	7,010,239	6,557,825	6,063,952	5,904,222
Insurance taxes, licenses and fees, excluding federal income taxes	998,080	933,940	1,000,288	983,228	944,621
Increase in loading on deferred and uncollected premiums. (Note 5)	130,533	(91,847)	21,544	108,242	4,083
Aggregate write-ins for deductions	165,767	92,693	85,687	151,286	181,122
Total deductions	\$41,297,693	\$38,484,284	\$ 37,813,789	\$ 36,243,576	\$ 34,591,229
Net gain from operations before dividends to policyholders and FIT	\$ 2,793,169	\$2,913,945	\$ 2,444,674	\$ 2,327,000	\$2,047,483
Dividend to policyholders	17,782	18,824	19,902	20,078	15,996
Net gain from operations after dividends to policyholders and before FIT	\$ 2,775,387	\$ 2,895,121	\$ 2,424,772	\$ 2,306,922	\$ 2,031,487
Federal and foreign income taxes incurred	612,878	470,084	366,668	532,025	304,437
Net gain from operations after dividends to policyholders and FIT and before realized capital gains or (losses)	2,162,509	2,425,037	2,058,104	1,774,897	1,727,050
Net realized capital gains or (losses) transferred to the IMR)	(811,112)	(92)	21	60,041	(126,110)
Net income	\$ 1,351,397	\$ 2,424,945	\$ 2,058,125	\$ 1,834,938	\$ 1,600,940

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN THIS REPORT ARE AN INTEGRAL PART THEREOF.

LIFE INSURANCE COMPANY OF ALABAMA
STATEMENT OF CHANGES IN CAPITAL AND SURPLUS
For the Years Ended December 31, 2008, 2007, 2006, 2005, and 2004

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Capital and surplus, December 31, prior year	\$16,632,394	\$ 14,442,552	12,280,672	10,940,253	8,801,363
Gains and (losses) in surplus:					
Net income	1,351,397	2,424,945	2,058,125	1,834,938	1,600,940
Change in net unrealized capital gains or (losses)	(2,731,900)	(390,680)	334,135	(401,691)	665,740
Change in net deferred income tax	1,147,694	85,774	(91,472)	143,095	(15,290)
Change in nonadmitted assets and related items	(1,452,091)	(92,257)	13,397	(33,283)	220,022
Change in asset valuation reserve	720,903	307,548	(71,149)	(17,222)	(250,500)
Dividend to Stockholders	(174,296)	(145,488)	(133,285)	(133,285)	(82,022)
Aggregate write-ins for gains and losses in surplus			52,129	(52,133)	
Net change in capital and surplus for the year	<u>\$ (1,138,293)</u>	<u>\$ 2,189,842</u>	<u>\$ 2,161,880</u>	<u>\$ 1,340,419</u>	<u>\$ 2,138,890</u>
Capital and surplus, December 31, current year	<u>\$15,494,101</u>	<u>\$16,632,394</u>	<u>\$14,442,552</u>	<u>\$12,280,672</u>	<u>\$10,940,253</u>

THE NOTES IMMEDIATELY FOLLOWING THE FINANCIAL STATEMENTS IN THIS REPORT ARE AN INTEGRAL PART THEREOF.

NOTES TO FINANCIAL STATEMENTS

Note 1 - Bonds

\$ 67,892,448

The captioned amount is the same as reported by the Company in its 2008 Annual Statement.

The examiners selected a sample of bonds from *Schedule D - Part 1* of the 2008 Annual Statement to verify the appropriateness of the amortization method used by the Company. The examiners determined that the bonds in the sample, which were bought at a discount, were being amortized to the call date of the bond instead of the maturity date of the bond. Amortizing the bonds, bought at discount, to the maturity dates would have produced the lowest asset value. The Company was not in compliance with SSAP No. 26, Paragraph 6, of the NAIC Accounting Practices and Procedures Manual, which states:

“Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond. Bonds containing call provisions (where the issue can be called away from the reporting entity at the issuer’s discretion) shall be amortized to the call or maturity value/date which produces the lowest asset value (yield to worst).”

The examiners reviewed the securities acquired during the period covered by the examination for compliance with the investment policy and procedures adopted by the Board of Directors. The Company’s investment policy limits investments to a maximum of \$500,000 for an AAA rated security or an NAIC 1 designation and a maximum of \$200,000 for securities which are less than investment grade or a NAIC designation of no less than 3. The examiners determined that at the time of acquisition, the securities listed below had the following NAIC designation, and were over the maximum limit required by the investment policy:

<u>No</u>	<u>Description</u>	<u>NAIC Designation</u>	<u>Amount</u>
1	Citizens Utilities	3	\$ 300,000
2	Fairfax Financial Holdings	3	300,000
3	Aegis Alabama Venture Fund, LP	1	1,711,172

The investment policy adopted by the Board of Directors, states:

“...D. Maximum holdings for AAA, AA credits will be \$500,000 per credit, for A & Baa credits also \$400,000 per name. The above limits do not apply to Government and Agency issues or those guaranteed by the U.S. Government.

E. Less than investment grade issues will be limited to \$200,000 for each credit. Specific securities purchased will be approved or subject to no less than NAIC 3 classifications....”

The Company was asked if management regularly reviews its bond securities for other than temporary impairments. Company management stated that the investment committee reviews the bond securities with an NAIC designation of “5” or higher for other than temporary impairments. The examiners determined that the bond securities listed under Industrial and Miscellaneous issuers’ obligation in Schedule D - Part 1 with a NAIC designation of “6” were appropriately written down to the fair value. However, there was no documentation in the minutes of the Investment Committee meetings that suggested that the impairment of the bond securities was on the agenda for discussion, which was not in compliance with ALA. CODE § 10-2B-16.01(1975), which states:

“(a) A corporation shall keep as permanent records minutes of all meetings of its shareholders and board of directors, a record of all actions taken by the shareholders or board of directors without a meeting, and a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation.”

For subsequent events, the examiner reviewed the June 30, 2009 Quarterly Statement and determined that two securities had been downgraded to a NAIC designation of “6”. These securities were not reported at the lower of the amortized cost or fair value as required by SSAP No. 26, paragraph 7, of the NAIC Accounting Practices and Procedures Manual, which states:

“...For reporting entities that maintain an Asset Valuation Reserve (AVR), the bonds shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value....”

Company management had indicated that investments are reviewed for impairment by the investment committee; however, the securities which were downgraded to NAIC designation of “6” were not reported at the fair value as required by the aforementioned SSAP. The Company should have an internal control in place to review securities for impairments on a quarterly basis, and to then write-down the

book value of those securities found to be impaired to the fair value of the securities at the time of impairment. Since Company management indicated that the impairment of securities is reviewed by the investment committee, it would be a good business practice to update the investment committee's charter, and include the review of securities for impairments as one of the duties of the investment committee.

Note 2 - Cash, cash equivalents, and short-term investments:

\$ 775,927

The captioned amount is the same as reported by the Company in its 2008 Annual Statement.

The Company had \$870,000 on deposit, under an overnight fund transfer repurchase agreement with Regions Bank at December 31, 2008. The investment under the repurchase agreement was reported on *Schedule E - Part 2 - Cash Equivalents* instead of *Schedule DA - Part 1 - Short-Term Investments*. The NAIC Annual Statement Instructions, Schedule DA - Part 1, states:

“Include all investments whose maturities (or repurchase dates under repurchase agreements) at the time of acquisition were one year or less except those defined as cash in accordance with SSAP No. 2, Cash, Drafts, and Short-Term Investments...”

Note 3 - Receivables for securities

\$-0-

The captioned amount is \$364,428 less than the \$364,428 reported by the Company in its 2008 Annual Statement.

The \$364,428 reported by Company in the 2008 Annual Statement was not admitted because the Company did not have a custodial agreement with Merrill Lynch. In order to place securities for safekeeping or custody with Merrill Lynch, the Company must have a custodial agreement with Merrill Lynch that is authorized by a resolution of the Board of Directors or a Committee of the Board of Directors of the Company and that is approved by the Commissioner of Insurance of the State of Alabama to be in compliance with ALA. ADMIN. CODE 482-1-077-.04 (2003), which states:

“(1) An insurance company may, by written agreement with a custodian, provide for the custody of its securities with a custodian. The securities may be held by the custodian or its agent or in a clearing corporation or in the Federal Reserve book-entry system. Securities so held, whether held by the custodian or its agent or in a clearing corporation or in the Federal Reserve book-entry

system, are referred to herein as “custodied securities”. (2) The agreement shall be in writing and shall be authorized by a resolution of the board of directors of the insurance company or of an authorized committee of the board....(2)(o) The custody agreement is of no force and effect until the Commissioner approves, in writing, the custody agreement.”

The examiners determined that the Company sold a security through Merrill Lynch Business Investor Account, and recorded the amount as receivable for securities when the proceeds from the sale had already been received as of December 31, 2008. Since the Company recorded the proceeds from the sale of security already received as receivable, the Company did not comply with the guidance provided by SSAP No. 21, paragraph 7, of the NAIC Accounting Practices and Procedures Manual, which states:

“Sales of securities are recorded as of the trade date. A receivable due from the broker is established in instances when a security has been sold, but the proceeds from the sale have not yet been received....”

The examiners reviewed the Merrill Lynch Business Investors Account and determined that the proceeds from the sale of the security was held in cash or cash equivalent and should have been recorded under *Cash, cash equivalent and short-term investments* in accordance with the guidance provided by the NAIC Annual Statement Instructions, which states:

“Line 5 - Cash, Cash Equivalents and Short-term Investments Include: All cash including petty cash, other undeposited funds and certificates of deposit in banks or other similar financial institutions with maturity dates of one year or less from the acquisition date and other instruments defined as cash and cash equivalents in accordance with SSAP No. 2, Cash, Drafts and Short-term Investments.”

**Note 4 – Uncollected premiums and agents’ balances in
course of collection**

\$ 479,199

The captioned amount is \$279,903 less than the \$759,102 reported by the Company in its 2008 Annual Statement. The following adjustments were made to the financial statements:

	<u>DESCRIPTION</u>	<u>Admitted 2008 A/S</u>	<u>Adjustments</u>	<u>Per Examination</u>
1.	Agents advance balance	\$ 264,791	\$ 264,791	\$ 0
2.	Due and uncollected premiums	494,311	15,112	479,199
		\$ 759,102	\$ 279,903	\$ 479,199

1. Agents advance balance: A review of the accounts and records indicated that the *Uncollected premiums and agents' balance in course of collection* included balances resulting from advances to agents for \$788,310, of which \$264,791 was less than 90 days past due and admitted by the Company for the purpose of statutory reporting as of December 31, 2008. A review of the Agents Agreement indicated that the balances were unsecured advances and that the contractual terms for repayment were through the application of future renewal commissions or other credits. ALA. CODE § 27-37-2 (1975), states:

“In addition to assets impliedly excluded by the provisions of Section 27-37-1, the following expressly shall not be allowed as assets in any determination of the financial condition of an insurer:

...(2) Advances to officers, directors, and controlling stockholders, other than policy loans, unless the same are secured by collateral satisfactory to the commissioner, and advances to employees, agents, and other persons on personal security only;”

2. Due and uncollected premiums: The examiners determined that the due and uncollected premiums in the amount of \$479,199 reported by the Company in the 2008 Annual Statement included \$121,738 in gross due and uncollected life insurance premiums. The amount of loading for \$15,112 should have been deducted from the gross premiums. The net amount should have been included in the *Uncollected premiums and agents' balance in course of collection*. The guidance provided by NAIC Annual Statement Instructions states:

“Line 13.1 - Uncollected premiums and Agents' Balances in Course of collection.

Include: Direct and group billed uncollected premiums...
Accident and health premiums due and unpaid.
Life insurance premiums and annuity considerations uncollected on in force business (less premiums on reinsurance ceded and less loading).”

The examiners determined that twenty-six accident and health insurance policies with premiums over ninety days past due were on the in-force listing. Twenty policies had lapsed during 2008, and six policies were in-force or reinstated in 2009. Company management indicated that the policies were kept on the in-force listing because the Company had contacted the agents to follow up with the group or individual policyholders. The Company should review policies with overdue premiums and follow its cancellation policy.

Note 5 – Deferred premiums, agents’ balances and installments booked but deferred **\$2,067,917**

The captioned amount is the same as reported by the Company in its 2008 Annual Statement.

Cancellation/Lapse Policy

The examiner reviewed the Company’s premium database used to calculate the due, deferred and advance premiums, for accuracy of the reserve determinants and compliance with the life and accident and health policies cancelling/lapsing practices followed by the Company. The examiners identified nineteen life insurance policies which had premiums over ninety days past due and while the policies were not cancelled, the Company reported deferred premium of \$2,419, under *Deferred premiums, agents’ balance and installments booked but deferred and not yet due*. The nineteen policies did not have any due premiums; however, all nineteen policies, and one additional policy on which a death claim had been paid, had statutory reserves included in the *Aggregate reserves for life contracts* of \$13,555. The examiners determined that nine of the nineteen policies were in-force subsequent to December 31, 2008.

The examiners determined that the Company was not following its cancelling/lapsing practices. The Company should have a written cancelling/lapsing policy, which is adopted by the Board of Directors, which will allow the Company to take appropriate and timely actions to cancel policies and manage potential liability arising from non-cancellation of a policy.

Reserve Determinants

The premium database was checked for accuracy of the reserve determinants used to calculate the deferred premiums and aggregate reserves. A sample of 45 policies and riders attached to the 45 policies were reviewed and compared to the original records. The examiners identified two policy applications on which the policyholders had selected the waiver of premium rider and were being charged premiums; however, it

was determined that the riders on the policies were not activated in the database. Company management indicated that the rider was not issued. In addition, there was one policy in the sample for which the annualized premium reported on the database did not match the original records.

Recalculation of Due, Deferred and Advance Premiums

The review of the reserve determinants in the premium database with the original records included the recalculation of due, deferred and advance premiums. The examiners recalculated the due, deferred and advance premium for a sample of policies taken from the premium database and determined that the calculations on two policies did not agree with the Company's calculations. Company management indicated that the computer program used by the Company's opining actuary calculates the due, deferred and advance premium and the output is reviewed by the opining actuary.

- On one policy, the premiums were paid to the next policy anniversary date, which was before the reporting date, for a monthly premium paying policy. The due premium amount calculated by the company equaled the annualized premium for the policy. The policy also reported advance premium in the amount of the annualized premium. The examiners calculation indicated that the Company had one month of due premium and eleven months of deferred premiums. The end effect on the surplus of the Company would be an under reporting of a months premium; therefore, an additional sample was not reviewed due to this error.
- On another policy, the premiums were paid past the reporting date but one installment short of the next policy anniversary date for the monthly mode policy. The Company reported two months of deferred premium and one month of advance premiums. The examiners calculation indicated that the Company should have reported one installment of deferred premiums and no advance premiums. The effect on the surplus is zero; therefore, an additional sample of policies was not selected.

Under the mean reserve method used by the Company to calculate aggregate reserves, the Company should have calculated the deferred premiums in accordance with the guidance provided by SSAP No. 51, paragraph 23, of the NAIC Accounting Practices and Procedures Manual, which states:

“...deferred premiums are computed by taking the gross premium (or premiums) extended from (and including) the modal (monthly, quarterly,

semiannual) premium due date or dates following the valuation date to the next policy anniversary date and subtracting any such deferred premiums that have actually been collected....”

The Company also did not comply with the SSAP No. 51, paragraph 25, of the NAIC Accounting Practices and Procedures Manual, which states:

“Advance premiums are those premiums that have been received by the reporting entity prior to the valuation date but which are due on or after the next policy anniversary date....”

<u>Note 6 – Aggregate reserve for life contracts</u>	<u>\$ 33,013,740</u>
<u>Aggregate reserve for A & H contracts</u>	<u>\$ 20,390,500</u>

The captioned \$33,013,740 is the same as reported by the Company in its 2008 Annual Statement. The captioned \$20,390,500 is the same as reported by the Company in its 2008 Annual Statement.

The examiners used the in-force policies database received from the Company’s opining actuary on which the *Aggregate reserve for life contracts* was calculated as of December 31, 2008. The examiners reconciliation of the database to *Exhibit 5 – Aggregate Reserve for Life Contracts*, for the accuracy of the reserve amount, and *Exhibit of Life Insurance*, for the number of policies and amount of insurance, indicated the following:

- *Exhibit of Life Insurance* had 21,265 in-force policies at year-end 2008; the in-force database had 20,729 in-force policies for a difference of 536 policies.
- The amount of insurance on *Exhibit of Life Insurance* was \$690,113,000, and the amount on the database was \$685,536,643, for a difference of \$4,576,569.
- The aggregate reserve reported on *Exhibit 5 – Aggregate Reserve for Life Contracts* agreed with the database.

The number of policies in-force and the amount of insurance in-force on *the Exhibit of Life Insurance* should agree with the number of policies in-force and the amount of insurance in-force on which the reserve is calculated and reported on *Exhibit 5 – Aggregate Reserve for Life Contracts*.

The examiners determined that the report used to update the number of policies and the amount of insurance in *Exhibit of Life Insurance* was generated by the Company’s

computer system from the in-force database. The report provided the following details included in the exhibit: 1) policies issued during the year, 2) policies revived during the year, 3) death claims paid, and 4) policy expiry, surrender and lapse. Company management indicated that the database from which the report was generated had all the policies in-force and included policies which were entered into the computer system but the effective dates fell outside the valuation date and the first premium to activate the policies was not collected. The examiners determined that the in-force database on which the policy-by-policy reserve was calculated did not include the policies with an effective date after the valuation date. Hence, the number of policies in-force reported in Column 3, line 21, and the amount of insurance reported in Column 4, line 21, were not accurately stated. Hence, the Company did not complete the *Exhibit of Life Insurance* in accordance with the guidance provided by NAIC Annual Statement Instructions, which states:

“**Exhibit of Life Insurance** - This exhibit displays current year information on increase and decrease to the life insurance in force at the beginning of the year. Data is reported on an incurred basis, that is, policies (or certificates) are considered issued when the first premium is paid and are considered terminated as closely as possible to the time when the event occurs rather than when actual cash payment is made....”

The examiners compared the Company’s in-force dental policy detail as of December 31, 2008 with the Actuary’s in-force dental policy detail as of the same date, and determined that there were 583 dental policies with a total annualized premium of \$300,741 which were in-force as of December 31, 2008, but were not included in the Actuary’s in-force dental policy detail which is used for valuation purposes. The amount, if any, of reserves for these policies would have been immaterial, and so the financial statements contained in this report were not changed. The Company should include all dental policies which are in-force as of December 31st of each year, in the detail of in-force dental policies, which is used for valuation purposes, as of December 31st of each year.

Note 7 – Contract claims: Life

\$ 514,149

The captioned \$514,149 is the same as reported by the Company in its 2008 Annual Statement, but \$47,733 less than that determined by the examination.

In *Exhibit 8 - Claims for Life and Accident and Health Contracts Part 1 - Liability* of the 2008 Annual Statement, the examiner determined that the Company calculated the contract claim liability by taking into account: 1) In course of settlement and 2) Incurred but not reported (IBNR) claims liability. The in course of settlement liability

of \$5,141 under line 2.21 of Exhibit 8 was estimated to be one percent of the total contract claims liability of \$514,149. The examiners calculation indicated that life claims reported to the Company before December 31, 2008, and in various stages of settlement was \$58,015, which was \$47,733 more than the \$5,141 reported by the Company. The Company should maintain a listing of all reported claims in course of settlement as of the reporting date and comply with the NAIC Annual Statement Instructions, which states:

“Line 1 - *Due and Unpaid*. Include: Only claims which are complete except for the payment of the amount due, or the recording of the amount paid in the appropriate claims accounts.

Line 2 – *In Course of Settlement*. Include: other contract claims that have been reported and are pending at the end of the year. They represent cases that are at different stages of completion of claim processing; ranging from the time of initial receipt of claims or notification of claims to the time where the cases are nearly complete, but not complete enough to be shown in Line 1. Claims in course of settlement are segregated between Resisted, Line 2.1 and Other, Line 2.2”

The retrospective review done to assess the accuracy of the estimation process by the examiners indicated the loss liability of \$514,149 did not show a pattern of underestimation of the liability.

**Note 8 – Premiums and annuity considerations for life and
accident and health contracts received in advance \$475,936**

The captioned amount is the same as reported by the Company in its 2008 Annual Statement.

The examiners determined that the advance premium listing included premiums received by the Company prior to the valuation date but which were due on or before the next anniversary date. The Company did not comply with the guidance provided by SSAP No. 51, paragraph 25, of the NAIC Accounting Practices and Procedures Manual, which states:

“Advance premiums are those premiums that have been received by the reporting entity prior to the valuation date but which are due on or after the next policy anniversary date. The policyholder may remit one or more premiums in advance of specific due dates....”

Company management indicated that a more traditional definition of advance premiums was used in the calculation of advance premiums. However, going forward the Company will comply with SSAP No. 51, paragraph 25.

Note 9 - Commissions to agents due and accrued

\$163,311

The captioned amount is the same as reported by the Company in its 2008 Annual Statement, but \$2,805 less than that determined by the examination.

The review of the agents manual indicated that commissions due to agents are payable as earned on a monthly basis on all premiums received and entered into the Company's computer through the last working day of each month. The commission checks are not issued when the earned commission is less than \$25. The accounts and records indicated that earned commissions for which checks were not issued to agents in the amount of \$2,805 were not expensed as incurred as of December 31, 2008, which was not in accordance with the guidance provided by SSAP No. 71, paragraph 2, of the NAIC Accounting Practices and Procedures Manual, which states:

“...Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5 - Liabilities, Contingencies and Impairments of Assets.”

The \$163,311 amount reported by the Company in the 2008 Annual Statement was determined to be commissions on due premiums on Life and Accident and Health insurance policies written by the Company. The commissions were calculated in the aggregate by multiplying the due premiums, first year and renewal, by the commission and expense factors calculated by the Company's opining actuary through an unpaid commission study. The commissions to agents should be calculated on a policy-detail level by taking into consideration the type of insurance products and the commission rate for the products, so that the Commission to agents due and accrued is not an approximation. The prior examination had also recommended that the Company calculate the commissions on a policy-detail basis.

Note 10 – General expenses due and accrued

\$1,208,468

The captioned amount is the same as reported by the Company in its 2008 Annual Statement.

The review of the accounts and records indicated that the Company did not accrue for legal expenses and the estimated settlement amount for open lawsuits against the

Company. SSAP No. 5, paragraph 7, of the NAIC's Accounting Practices and Procedures Manual states:

“An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both the following conditions are met:
 7a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and
 7b. The amount of loss can be reasonably estimated.”

There was no change made to the financial statements because the Company maintained that the accident & health reserving methodology used by the Company results in redundant reserves for accident & health policies. The Company maintains that the redundancy more than covers the contingent liabilities of legal expenses and estimated settlement amounts for open lawsuits against the Company on the as-of date of the Annual Statement.

A similar recommendation was made in the preceding report of examination. See caption CONTINGENT LIABILITIES AND PENDING LITIGATION in this report.

Note 11 – Unassigned funds (surplus) **\$12,947,784**

The unassigned funds (surplus) balance of the Company, as determined by this examination, was \$644,331 less than the \$13,592,115 reported by the Company in its 2008 Annual Statement. The following presents a reconciliation of unassigned funds per the Company's filed Annual Statement to that developed by this examination.

Unassigned funds per Company		\$13,592,115
<u>Examination increase / (decrease) to assets:</u>		
• Receivables for securities (Note 4)	\$ (364,428)	
• Uncollected premiums and agents' balances in course of collection (Note 5)	(279,903)	
Total - Decrease in Assets	\$ (644,331)	
<u>Examination (increase) / decrease to liabilities:</u>		
Total decrease in surplus		<u>\$ (644,331)</u>
Unassigned funds (surplus) per examination		<u>\$12,947,784</u>

CONTINGENT LIABILITIES AND PENDING LITIGATION

The examination for contingent liabilities and pending litigation included the review of the Company's statutory financial statement disclosures, minutes of the corporate governing bodies, pending claims, and the usual examination of accounts and unrecorded items. The examiners obtained the letters of representation from management and reviewed the external auditors' summary of pending litigation as of December 31, 2008. This review did not disclose any items that would have a material effect on the Company's financial condition in the event of an adverse outcome.

The examiners determined that the Company did not comply with some of the prior exam recommendation. See Note 12 – General expenses due and accrued caption under NOTES TO FINANCIAL STATEMENTS.

A similar recommendation was made in the preceding report of examination.

COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

Conflict of interest - The preceding report of examination recommended that the Company have all officers and directors sign a conflict of interest statement each year. The Company did not comply with the recommendation.

Travel expenses - In a review of the Company's Travel and Business Expense Reimbursement Policy the examiner determined that the policy was not approved by the Board of Directors of the Company and implemented until February 16, 2009. The prior report of examination as of December 31, 2003 recommended that the Company establish and adhere to a formal travel policy to avoid the appearance of impropriety and to assure consistency of benefits for all officers and employees of the Company. Since the Travel Policy was not approved and implemented until after the current period of examination ending on December 31, 2008, the Company was not in compliance with the recommendation of the prior examination.

Disaster Recovery Plan & Information System Controls - The preceding report of examination recommended that the Company develop procedures or polices which required department management to periodically validate the system-level access capabilities of individuals in their departments. Additionally, it was recommended the disaster recovery plan should be tested and the results of testing documented. During this examination it was determined access review and disaster recovery testing procedures need to be developed.

Commissions to agents due and accrued - The preceding report of examination recommended that the Company calculate its Commissions to agents due and accrued liability on a policy-detail level so that the amount will be adequate and not an approximation. The Company did not comply with this recommendation. It is again recommended that the Company calculate the commission on a policy-detail level.

Contingent liabilities and pending litigations – The preceding report of examination recommended that the Company set up a liability for the legal expenses and anticipated settlement amounts in accordance with SSAP No. 5, paragraph 7 and 9. The Company complied with paragraph 9; however, the Company did not comply with SSAP No. 5, paragraph 7.

COMMENTS AND RECOMMENDATIONS

Committees – Page 7

It is recommended that the Company keep permanent records of all actions taken by the audit committee of the board of directors in accordance with ALA. CODE § 10-2B-16.01 (1975), which states:

“A corporation shall keep as permanent records minutes of all meetings of its shareholders and board of directors, a record of all actions taken by the shareholders or board of directors without a meeting, and a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation.”

Conflict of Interest – Page 8

It recommended that the Company have all Officers, Directors, and Key Employees of the Company sign the conflict of interest statements for each year they are employed with the Company and comply with ALA. CODE § 10-2B-8.62(1975), which states:

“(b) If a director has a conflicting interest respecting a transaction but neither the director nor a related person of the director specified in Section 10-2B-8.60(3)(i) is a party to the transaction such that the director may not make the disclosure described in Section 10-2B-8.60(4)(ii), then disclosure is sufficient for purposes of subsection (a) if the director (1) discloses to the directors voting on the transaction the existence and nature of his or her conflicting interest and informs them of the character and limitations imposed by that duty

before their vote on the transaction and (2) plays no part, directly or indirectly, in their deliberations or vote.”

Section 1033 of Title 18 of the U.S. CODE – Page 13

It is recommended that the Company adopt an internal policy for determining, by means of background checks or investigations or otherwise, that those with whom the Company does business meet the requirements of this Section 1033 as required by ALA. ADMIN. CODE 482-1-146.11 (2009), which states:

“Responsibilities of Section 1033 Insurers:

(1) A Section 1033 insurer subject to the Commissioner’s examination authority shall have and apply the following:

(a) An internal procedure for determining, by means of background checks or investigations or otherwise, whether applicants for employment or individuals with whom the insurer intends to contract for activities in the business of insurance, whether or not in a capacity requiring a license, have a felony conviction for a Section 1033 offense.

(b) An internal procedure after initial employment or contracting, applied on a periodic basis, to ascertain the existence of a felony conviction for a Section 1033 offense.”

The above recommendation is effective as of July 1, 2009

Special Deposit – Page 14

It is recommended that the Company report the statutory deposits for states other than the state of domicile under columns 5 and 6 of *Schedule E - Part 3 - Special Deposits* in accordance with the guidance provided by the NAIC Annual Statement Instructions, which states:

“Columns 5 and 6 - All other Special Deposits - Report any deposits not included in Column 3 and 4 which are held for any special or statutory purpose.”

It is recommended that the Company maintain the statutory deposits in the State of Arkansas in accordance with the requirements of that state.

Underwriting, Policy Forms and Rating Practices – Page 16

It is recommended that the Company appropriately file with the ALDOI annual actuarial certifications for policies that are to be marketed with or without an illustration in accordance with the requirements of ALA. ADMIN. CODE 482-1-114-.05 (A) (1998), which states:

“Each insurer marketing policies to which this chapter is applicable shall notify the commissioner whether a policy form is to be marketed with or without an illustration. For all policy forms being actively marketed on the effective date of this chapter, the insurer shall identify in writing those forms and whether or not an illustration will be used with them. For policy forms filed after the effective date of this chapter, the identification shall be made at the time of filing. Any previous identification may be changed by notice to the commissioner.”

It is recommended that if the Company states that they will not illustrate the policy that they comply with ALA. ADMIN. CODE 482-1-114-.05 (B) (1998), which states:

“If the insurer identifies a policy form as one to be marketed without an illustration, any use of an illustration for any policy using that form prior to the first policy anniversary is prohibited.”

It is recommended that the Company have established, written, and printed underwriting guidelines in a text or manual format. The Underwriting Guidelines should explain in detail the basis for how policies are rated, individual and group selection, and the criteria utilized by underwriters to determine the Company's risk assessment and selection of an applicant.

Claims Payment Practices – Page 19

It is recommended that the Company maintain evidence of all canceled claim checks in accordance with the requirements of ALA. CODE 27-27-29 (a) (1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds of insurance transacted.”

Policyholders' Complaints – Page 19

It is recommended that the Company respond to all complaints (consumer direct and ALDOI) within ten day in accordance with the requirements of ALA. ADMIN. CODE 482-1-118-.06 (1999), which states:

“The insurer shall provide, within ten (10) working days, any record or response requested in writing by any duly appointed deputy, assistant, employee or examiner of the Commissioner. When the requested record or response is not produced or cannot be produced by the insurer within ten working days, the nonproduction shall be deemed a violation of this rule, unless the Commissioner or duly appointed person making the request grants an extension in writing or the insurer can demonstrate to the satisfaction of the Commissioner that there is a reasonable justification for the delay.”

Compliance with agents' licensing requirements – Page 20

It is recommended that the Company document in its listing all agents that are canceled and terminated in accordance with ALA. CODE 27-27-29 (a) (1975), which states:

“(a) Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

It is recommended that the Company or an authorized representative of the insurer document in its listing all agents that are canceled and terminated in accordance with ALA. CODE 27-27-29 (a) (1975), which states:

“(a) Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

It is recommended that the Company maintain an appointed agents' listing that is both complete and current in accordance with the requirements of ALA. CODE 27-27-29 (a) (1975), which states:

“Every domestic insurer shall have, and maintain, its principal place of business and home office in this state and shall keep therein complete records of its assets, transactions, and affairs in accordance with such methods and systems as are customary or suitable as to the kind, or kinds, of insurance transacted.”

Privacy policy and practices – Page 22

It is recommended that the Company comply with its own privacy policies and procedures to have all employees sign the Employee Confidentiality Agreement.

Accounts and Records – Page 28

It is recommended that the Company obtain an awareness letter from Barfield, Murphy, Shank and Smith PC, external auditor, and file the copy of the letter with the Commissioner of Insurance as required by ALA. ADMIN. CODE 482-1-100-.06 (2004), which states:

“(2) The insurer shall obtain a letter from the accountant, and file a copy with the Commissioner stating that the accountant is aware of the provisions of the insurance code and the rules and regulations of the insurance department of the state of domicile that relate to accounting and financial matters and affirming that the accountant will express his or her opinion on the financial statements in terms of their conformity to the statutory accounting practices prescribed or otherwise permitted by that insurance department, specifying such exceptions as he or she may believe appropriate.”

It is recommended that the Company file the report of Unclaimed Property as required by ALA. CODE § 35-12-76(c) (2004), which states:

“The report shall be filed before November 1 of each year and cover the 12 months next preceding July 1 of that year.”

It is recommended that the Company establish a formal written record retention policy and procedure that will ensure compliance with ALA. ADMIN. CODE 482-1-118-.03 (1999), which states:

“Every insurer, which term shall include every domestic insurer, foreign insurer, health care services corporation, health maintenance organization, prepaid dental plan, managing general agent or any other legal entity regulated by the Insurance Code and licensed to do business in this state shall maintain its books, records, documents and other business records in order that the

insurer's financial condition may be readily ascertained by the Department of Insurance, taking into consideration other record retention requirements. All records must be maintained for not less than five (5) years.”

It is recommended that the Company test its disaster recovery plan.

It is recommended that the Company store recovery and backup data at a storage facility that is climate controlled.

It is recommended the Company implement a disaster recovery plan that reduces the risk of data loss from a localized adverse event.

It is recommended the password aging and history parameters of system level software are set to force users to change passwords at least quarterly and not allow the reuse of the same password.

It is recommended that the Company establish written procedures for the prevention, detection, and elimination of fraud and the procedures should include the reporting of fraudulent insurance acts to the commissioner of insurance, which meet the requirements of ALA. ADMIN. CODE 481-1-054-.03(1) (2003), which states:

“(1) The Commissioner of Insurance shall be notified within thirty days of the happening of any one or more of the following:

- (a) The suspension or revocation of a licensee's license, certificate of authority, or right to transact business in another state....
- (e) The filing of a civil lawsuit, the rendering of a verdict, or the finding of a court against a producer, where such lawsuit, verdict, or finding of a court alleges or charges the producer with committing any of the following acts in the State of Alabama: intentional misrepresentation, fraud, dishonesty, misappropriation or conversion of funds, a breach of a fiduciary duty, or any other offense involving a breach of trust....

(2) The notice required in this rule shall be provided by the licensee directly involved in any such event.”

Bonds – Page 37

It is recommended that the Company amortize bonds bought at a discount to the maturity date instead of the call date in order to produce the lowest asset value in

accordance with the guidance provided by SSAP No. 26, Paragraph 6 of the NAIC Accounting Practices and Procedures Manual, which states:

“Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond. Bonds containing call provisions (where the issue can be called away from the reporting entity at the issuer's discretion) shall be amortized to the call or maturity value/date which produces the lowest asset value (yield to worst).”

It is recommended that the Company require its investment manager to comply with the Company's investment guidelines as written in the investment policy, and that the Company monitors its investments to comply with its own guidelines.

It is recommended that the investment committee keep documentation of its meetings in order to be in compliance with ALA. CODE § 10-2B-16.01 (1975), which states:

“(a) A corporation shall keep as permanent records minutes of all meetings of its shareholders and board of directors, a record of all actions taken by the shareholders or board of directors without a meeting, and a record of all actions taken by a committee of the board of directors in place of the board of directors on behalf of the corporation.”

It is recommended that the Company review securities for impairments and write-down the impaired securities to the fair value of the securities in accordance with SSAP No. 26, paragraph 7, of the NAIC Accounting Practices and Procedures Manual, which states:

“...For reporting entities that maintain an Asset Valuation Reserve (AVR), the bonds shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value....”

In order to comply with SSAP No. 26, the Company should have an internal control in place to review securities for impairments on a quarterly basis so that the securities which are found to be impaired are reported at the fair value at the time of impairment. It would also be a good business practice to update the investment committee's charter, and include the review of securities for impairments as one of the duties of the investment committee.

Cash and short-term investment – Page 39

It is recommended that the Company report repurchase agreement transactions in Schedule DA - Part 1 - Short-Term Investments in accordance with the NAIC Annual Statement Instructions, which states:

“Include all investments whose maturities (or repurchase dates under repurchase agreement) at the time of acquisition were one year or less except those defined as cash or cash equivalents in accordance with SSAP No. 2, Cash, Drafts, and Short-term Investments...”

Receivable from securities – Page 39

It is recommended that the Company have custodial agreements as required by ALA. ADMIN. CODE 482-1-077-.04 (2003), which states:

“(1) An insurance company may, by written agreement with a custodian, provide for the custody of its securities with a custodian. The securities may be held by the custodian or its agent or in a clearing corporation or in the Federal Reserve book-entry system. Securities so held, whether held by the custodian or its agent or in a clearing corporation or in the Federal Reserve book-entry system, are referred to herein as “custodied securities”. (2) The agreement shall be in writing and shall be authorized by a resolution of the board of directors of the insurance company or of an authorized committee of the board...(2)(o) The custody agreement is of no force and effect until the Commissioner approves, in writing, the custody agreement.”

It is recommended that the Company only record proceeds from the sale of securities that have not yet been received under Receivable for securities as required by SSAP No. 21, paragraph 7, of the NAIC Accounting Practices and Procedures Manual, which states:

“Sales of securities are recorded as of the trade date. A receivable due from the broker is established in instances when a security has been sold, but the proceeds from the sale have not yet been received...”

It is recommended that the Company record all cash or cash equivalents with financial institutions under *Cash, cash equivalents and short-term investments* in accordance with the guidance provided by the NAIC Annual Statement Instructions, which states:

“Line 5 - Cash, Cash Equivalents and Short-term Investments Include: All cash including petty cash, other undeposited funds and certificates of deposit in banks or other similar financial institutions with maturity dates of one year or less from the acquisition date and other instruments defined as cash and cash equivalents in accordance with SSAP No. 2, Cash, Drafts and Short-term Investments.”

Uncollected premiums and agents’ balances in course of collection – Page 40

It is recommended that the Company not admit unsecured advances to agents as required by ALA. CODE § 27-37-2 (1975), which states:

“In addition to assets impliedly excluded by the provisions of Section 27-37-1, the following expressly shall not be allowed as assets in any determination of the financial condition of an insurer:

...(2) Advances to officers, directors, and controlling stockholders, other than policy loans, unless the same are secured by collateral satisfactory to the commissioner, and advances to employees, agents, and other persons on personal security only;”

It is recommended that the Company report the due premiums (net of loading) in accordance with the guidance provided by the NAIC Annual Statement Instructions, which states:

“Line 13.1 – Uncollected Premiums and Agents’ Balance in Course of Collection.

Include: Direct and group billed uncollected premiums...

Accident and health premiums due and unpaid.

Life insurance premiums and annuity considerations uncollected on in force business (less premiums on reinsurance ceded and less loading).”

It is recommended that the Company adopt a formal written cancellation/lapsing policy, which will allow the Company to take appropriate and timely actions to cancel policies and manage potential liability arising from non-cancellation of a policy.

Deferred premiums, agents' balances and installment booked but deferred – Page - 42

It is recommended that the Company adopt a formal written cancellation/lapsing policy, which will allow the Company to take appropriate and timely actions to cancel policies and manage potential liability arising from non-cancellation of a policy.

It is recommended that the Company develop a policy and procedure to periodically review the premium database in order to ensure that the database accurately reflects the contracted terms of the policy when the policy is originally issued and that the policies reflect changes made to the policy during the life of the policy

It is recommended that the Company calculate the deferred, and advance premiums in accordance with the guidance provided by SSAP No. 51, paragraph 23, of the NAIC Accounting Practices and Procedures Manual, which states:

“...deferred premiums are computed by taking the gross premium (or premiums) extended from (and including) the modal (monthly, quarterly, semiannual) premium due date or dates following the valuation date to the next policy anniversary date and subtracting any such deferred premiums that have actually been collected....”

Aggregate reserve for life contracts – Page 42

It is recommended that the Company review its policy and procedures for reporting the policies in-force accurately, so that the in-force policies listed on the *Exhibit of Life Insurance* reconciles to the number of in-force policies on which the *Aggregate reserve for life contracts* is calculated and the *Exhibit of Life Insurance* is completed in accordance with the guidance provided by NAIC Annual Statement Instructions, which states:

“Exhibit of Life Insurance - This exhibit displays current year information on increase and decrease to the life insurance in force at the beginning of the year. Data is reported on an incurred basis, that is, policies (or certificates) are considered issued when the first premium is paid and are considered terminated as closely as possible to the time when the event occurs rather than when actual cash payment is made....”

It is recommended that the Company include all dental policies which are in-force as of December 31st of each year, in the detail of in-force dental policies, which is used for valuation purposes, as of December 31st of each year.

Contract claims- Life - Page 45

It is recommended that the Company report claims which are reported to the Company on or before December 31 of each year in accordance with the guidance provided by the NAIC Annual Statement Instructions, which states:

“Line 1 - *Due and Unpaid*. Include: Only claims which are complete except for the payment of the amount due, or the recording of the amount paid in the appropriate claims accounts.

Line 2 – *In Course of Settlement*. Include: Other contract claims that have been reported and are pending at the end of the year. They represent cases that are at different stages of completion of claim processing; ranging from the time of initial receipt of claims or notification of claims to the time where the cases are nearly complete, but not complete enough to be shown in Line 1. Claims in course of settlement are segregated between Resisted, Line 2.1 and Other, Line 2.2”

Premiums and annuity considerations for life and accident and health contracts received in advance – Page 46

It is recommended that the Company calculate advance premiums in accordance with the guidance provided by SSAP No. 51, paragraph 25, of the NAIC Accounting Practices and Procedures Manual, which states:

“Advance premiums are those premiums that have been received by the reporting entity prior to the valuation date but which are due on or after the next policy anniversary date...”

Commissions to agents due and accrued – Page 47

It is recommended that the Company include all commission expenses in the Annual Statement, including commissions payable to agents, for amounts less than \$25, for which checks were not issued as required by SSAP No. 71, paragraph 2, of the NAIC Accounting Practices and Procedures Manual, which states:

“...Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5 - Liabilities, Contingencies and Impairments of Assets.”

It is again recommended that the Company calculate the commissions on a policy-detail level, which is based on the type of insurance products and commission rate for the products so that the commission due and accrued liability is not an approximation.

General expenses due and accrued – Page 47

It is recommended that the Company accrue for legal expenses and the estimated settlement amount for open lawsuits against the Company in accordance with the guidance provided by SSAP No. 5, paragraphs 7 and 10, of the NAIC's Accounting Practices and Procedures Manual which state:

“An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both the following conditions are met: 7a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and 7b. The amount of loss can be reasonably estimated.”

SUBSEQUENT EVENTS

The examiner determined that there are no internal controls in place to review the travel expenses of the employees of the Company to ensure that they comply with the travel policy of the Company.

It is recommended that the Company have internal controls in place to review the travel expenses of the employees of the Company to ensure that they comply with the travel policy of the Company.

It is recommended that the Company include all shareholders who have 5% or more of the voting rights of the outstanding common shares of the Company in the registration statement that is filed with the Alabama Department of Insurance in order to be in compliance with Ala. Code § 27-29-4(d) (1975), which states: “Amendments to registration statements. Each registered insurer shall keep current the information required to be disclosed in its registration statement by reporting all material changes or additions on amendment forms provided by the commissioner within 15 days after the end of the month in which it learns of each such change or addition, but at least annually, as provided in subsection (a)...”

In a review of securities for impairment, the examiner determined that there were two bond securities, Cusip number 184502AA0 Clear Channel Communications and Cusip number 19560Q203 Colonial Capital Trust IV, which were not impaired as of December 31, 2008, but in a review of the securities in the subsequent period were found to have an NAIC Designation of 6. Schedule D of the 2nd Quarter 2009 Quarterly Statement was reviewed, and it was determined that the book value of the securities had not been written down to the fair value of the securities in accordance with Part Six, Section 1 of the NAIC Purposes & Procedures Manual, which states:

“A life insurance company that owns a bond that has been assigned a NAIC 6 Designation or a preferred stock with a NAIC 4, 5, or 6 Designation, and a property and casualty company that owns a bond or a preferred stock that has been assigned an NAIC Designation of 3, 4, 5, or 6 must carry the security at the lower of cost or amortized book value.”

The Company stated that there are controls in place to review securities for impairment but the Company could not provide documentation evidencing a review of securities for impairment, and so the examiner determined that the controls were not functioning properly. The Company should have an internal control in place to review securities for impairment on a quarterly basis, and to then write-down the book value of those securities found to be impaired to the fair value of the securities at the time of impairment. The review of the securities for impairment, and the supporting documentation of this review should be kept to evidence a review of securities for impairment on a quarterly basis.

CONCLUSION

Acknowledgement is hereby made of the courtesy and cooperation extended by all persons representing the Company during the course of the examination.

The customary insurance examination procedures, as recommended by the National Association of Insurance Commissioners, have been followed to the extent appropriate in connection with the verification and valuation of assets and the determination of liabilities set forth in this report.

In addition to the undersigned, Robert Thompson, Juliette Glenn, MCM, and Charles Turner, Examiners; and Harland Dyer, ASA, MAAA, FCA, Consulting Actuarial Examiner; all representing the Alabama Department of Insurance, participated in this examination.

Respectfully submitted,

Francis Blase Abreo

Blase Abreo, CFE
Examiner-in-charge
Alabama Department of Insurance