STATE OF ALABAMA
DEPARTMENT OF INSURANCE
MONTGOMERY, ALABAMA

# REPORT OF EXAMINATION

OF

**Life Insurance Company of Alabama**

GADSDEN, ALABAMA

AS OF DECEMBER 31, 2012

TABLE OF CONTENTS

**EXAMINER'S AFFIDAVIT**

**STATE OF ALABAMA**
**COUNTY OF ETOWAH**

Rhonda B. Ball, CFE, being duly sworn, states as follows:

1. I have the 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 workpapers 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.

Rhonda B Ball
Examiner-in-charge

Subscribed and sworn before me by Rhonda B. Ball on this 4th day of April, 2014.

(SEAL)

Libby Belyen
(Signature of Notary Public)

My commission expires May 3, 2014.

ROBERT BENTLEY
GOVERNOR

JIM L. RIDLING
COMMISSIONER

STATE OF ALABAMA
DEPARTMENT OF INSURANCE
201 MONROE STREET, SUITE 502
POST OFFICE BOX 303351
MONTGOMERY, ALABAMA 36130-3351
TELEPHONE: (334) 269-3550
FACSIMILE: (334) 241-4192
INTERNET: www.aldoi.gov

DEPUTY COMMISSIONER
CHARLES M. ANGELL (acting)

CHIEF EXAMINER
RICHARD L. FORD

STATE FIRE MARSHAL
EDWARD S. PAULK

GENERAL COUNSEL
REYN NORMAN

Gadsden, Alabama
April 4, 2014

Jim L. Ridling, Commissioner
Alabama Department of Insurance
P.O. Box 303351
Montgomery, Alabama 36130-3351

Dear Commissioner Ridling:

Pursuant to your authorizations and in compliance with the statutory requirements of the State of Alabama and the resolutions adopted by the National Association of Insurance Commissioners (NAIC), an examination has been made of the affairs and financial condition of

Life Insurance Company of Alabama
Gadsden, Alabama

at its home office located at 302 Broad Street, Gadsden, Alabama 35901 as of December 31, 2012. 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.

## SCOPE OF EXAMINATION

The Company was last examined for the five year period ended December 31, 2008 by examiners representing the State of Alabama. The current examination covers the intervening period from the date of the last examination through December 31, 2012 and was conducted by examiners representing the State of Alabama. Where deemed appropriate, transactions, activities and similar items subsequent to 2012 were reviewed.

The examination was conducted in accordance with applicable statutory requirements of the State of Alabama Code and in accordance with 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, 2012, and to identify the Company's prospective risks by obtaining information about the Company including corporate governance, by identifying and assessing inherent risks within the Company and by evaluating 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 financial statement presentation and management's compliance with statutory accounting principles and annual statement instructions.

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

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, operations controls, processing controls, e-commerce controls, and network and internet controls.

A market conduct examination was performed concurrently with the financial examination. The examination included reviews of the Company's territory and plan of operation, underwriting, policy forms and rate filings, advertising and marketing, claims payment practices, policyholders' complaints, compliance with producers' licensing requirements, and privacy standards. See "Market Conduct Activities" on page 12 for further discussion of the market conduct examination.

Thomas Howell Ferguson, P.A. was the Company's certified public accountants (CPAs) for 2012. Prior to 2012, the Company was audited by Barfield, Murphy, Shank & Smith PC. The examiners reviewed the CPAs' workpapers and incorporated these into the examination as deemed appropriate.

A signed certificate of representation was obtained during the course of 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, 2012.

## 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, 2012, 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. Treasury shares were held as follows: common stock ($5 par) 12,446 shares at a cost of $244,522 and Class "A" Common ($1 par) 404,827 shares at a cost of $473,845.

The 2012 Annual Statement reflected the following:

- Net Admitted Assets: $102,594,476
- Liabilities: $73,239,511

- Total Capital and surplus:
  - Common capital stock: $1,500,000
  - Gross paid in and contributed surplus: $1,810,697
  - Unassigned funds (surplus): $26,762,634
  - Treasury stock at cost: $718,366

## 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 7, 2012 and serving at December 31, 2012 were as follows:

| Name and Residence | Principal Occupation |
|---|---|
| Clarence William Daugette, III<br>Gadsden, Alabama | President and Chairman of the Board<br>Life Insurance Company of Alabama |
| Raymond Rudolph Renfrow, Jr<br>Gadsden, Alabama | Executive VP & Chief Marketing Officer<br>Life Insurance Company of Alabama |
| Herman Warren Cobb, Jr.<br>Dothan, Alabama | Attorney<br>Cobb, Derrick, Boyd & White |
| William Owen Leach, Jr.<br>Gadsden, Alabama | President<br>Leach & Company |
| Alburta Daugette Lowe<br>Gadsden, Alabama | Homemaker |
| Marvin Lynn Lowe<br>Gadsden, Alabama | Executive Vice President & Treasurer<br>Life Insurance Company of Alabama |
| Thomas Wesley Miller, Sr.<br>Birmingham, Alabama | Vice President Marketing<br>Nexcel Synthetics |
| Lucian Newman, Jr. MD<br>Gadsden, Alabama | Surgeon<br>Surgery Clinic, LLC |
| Anne Daugette Renfrow<br>Gadsden, Alabama | Homemaker |
| Rosalie Renfrow Causey<br>Gadsden, Alabama | Assistant VP & Assistant Secretary |

| | |
|---|---|
| Gerald Ray Smith, Jr.<br>Gadsden, Alabama | Chairman, Company's Audit Committee<br>CEO of Keystone Bank |

**Officers**

Officers elected by the Board of Directors on May 7, 2012 and serving at December 31, 2012 were as follows:

| Officers | Title |
|---|---|
| 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 |
| Jack Steven Keck | Senior VP and Secretary |
| Hoyt Russel Casey | VP |
| Katrina Davis Hulsey | VP |
| Jeffrey Lynn Casey | VP & Chief Technology Officer |
| Wanda Jean Snyder | VP & Chief Information Officer |
| Clarence Weyman Bracewell Jr. | VP & Agency Director |
| Libby Alaine Belyeu | Assistant VP and Assistant Treasurer |
| Rosalie Renfrow Causey | Assistant VP and Assistant Secretary |
| Debbie Ann Stearns Edmondson | Assistant VP |

**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, 2012:

Executive Committee
Clarence William Daugette, III, Chairman
William Owen Leach, Jr.
Marvin Lynn Lowe
Lucian Newman, MD

Audit Committee
Gerald Ray Smith, Jr., Chairman
William Owen Leach, Jr.
Mark Espy
Rosalie Renfrow Causey

Compensation Committee
William Owen Leach, Jr.
Thomas Wesley Miller, Sr.
Mark Carroll Espy, Jr.

Loan and Investment Committee
Clarence William Daugette, III
Marvin Lynn Lowe
William Owen Leach, Jr.
Raymond Rudolph Renfrow, Jr.

Salary Review Committee
Clarence William Daugette, III
Raymond Rudolph Renfrow, Jr.
Marvin Lynn Lowe

Corporate Governance Committee

| | |
|---|---|
| Thomas Wesley Miller | Gerald Ray Smith, Jr. |
| Clarence William Daugette, III | |

## 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. These statements were reviewed for each year under examination. No conflicts were noted and all requested statements were provided.

## CORPORATE RECORDS

The Company's Articles of Incorporation, By-Laws, and amendments thereto were inspected and found to provide for the operation of the Company in accordance with Alabama statutes and regulations and with accepted corporate practices.

Minutes of the meetings and actions of the Board of Directors during the examination period were reviewed. The minutes appeared to be complete with regard to recording 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:

| Year | Dividend Paid |
|---|---|
| 2009 | $167,127 |
| 2010 | $205,054 |
| 2011 | $215,306 |
| 2012 | $216,917 |

The dividends were reported to the Alabama Department of Insurance in accordance with ALA. CODE §27-29-4(d)(1975), which states in 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, 2012:

**Life Insurance Company of Alabama***
**NAIC Company code - 65412**

100% owned subsidiary

LICOA Brokerage Service, Inc.

***Clarence W. Daugette, III**

Ownership as of December 31, 2012

| | Common Stock | | Class A Common Stock | |
|---|---|---|---|---|
| | No. Shrs | %Outstanding | No. Shrs | %Outstanding |
| Direct | 11,213 | 12.81 | 18,534 | 3.15 |
| Indirectly in CBA Partners | 1,589 | 1.81 | 4,035 | 0.69 |
| Indirectly in LICOA Investment Club | 0 | 0.00 | 0 | 0.00 |
| Indirectly Trustee CESTUS Properties LLC | 27,374 | 31.27 | 29,650 | 5.05 |
| TOTAL | 40,176 | 45.89 | 52,219 | 8.89 |

In Moonglow, Jr. Properties, LLC**: Directly- 16.46% and Indirectly- 83.54%
In Rock-A-Bye Properties, LLC**: Directly- 1% and Indirectly- 99%

**Own no stock in the Company or LICOA Brokerage Service.

## 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 BONDS AND OTHER INSURANCE

The Company was a named insured on a financial institution bond issued by Fidelity and Deposit Company of Maryland, which met the suggested minimum requirements of the NAIC *Financial Condition Examiners Handbook*. In addition to the fidelity bond, the Company also maintained the following insurance policies to protect itself from hazards to which it may be exposed:

Commercial Property
General Liability
Commercial Auto
Umbrella Liability
Excess Liability
Workers Compensation

The coverage and retention limits carried by the Company were reviewed during the course of the examination and appeared to adequately protect the Company's interests at the examination date.

## SECTION 1033 OF TITLE 18 OF THE U.S. CODE

Under ALA. ADMIN. CODE 482-1-146 (2009), 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 to have a background check. Also, 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.

The Company was 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."

No internal policy or procedure was provided regarding those that the Company contracts to do business with.

## EMPLOYEE AND AGENT WELFARE

The Company provides benefits to 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

## SCHEDULE T – PREMIUMS AND OTHER CONSIDERATIONS

| | Direct Business Only | | | | |
|---|---|---|---|---|---|
| | Life Contracts | | | | 5 |
| | 1 | 2 | 3 | 4 | |
| States | Life Insurance Premiums | Annuity Considerations | Accident and Health Insurance Premiums, including Policy, membership and Other Fees | Total Columns 1 through 3 | Deposit-Type Contracts |
| Alabama | $2,332,005 | $24,172 | $ 8,942,250 | $11,298,426 | $ 3,938 |
| Arkansas | 145,517 | | 1,354,312 | 1,499,828 | |
| Florida | 66,746 | | 362,107 | 428,852 | 4,586 |
| Georgia | 808,096 | 2,457 | 4,723,919 | 5,534,472 | 3,365 |
| Kentucky | 326,414 | 196 | 2,775,459 | 3,102,069 | 729 |
| Louisiana | 49,228 | 1,842 | 298,543 | 349,613 | 196 |
| Mississippi | 591,194 | 623 | 5,153,962 | 5,745,779 | 396 |
| North Carolina | 109,046 | 2,476 | 1,115,059 | 1,226,582 | 2,476 |
| Oklahoma | 9,753 | | 123,437 | 133,190 | 1 |
| South Carolina | 946,309 | 1,561 | 1,635,402 | 2,583,272 | 424 |
| Tennessee | 664,345 | 22,404 | 5,573,509 | 6,260,258 | 3,495 |
| Total | $6,048,654 | $55,731 | $32,057,958 | $38,162,342 | $19,606 |

## SPECIAL DEPOSITS

The Company had the following securities on deposit with state authorities as of December 31, 2012 in order to satisfy the statutory deposit requirements of the various states in which the Company writes business:

| State | Statement Value | Fair Value |
|---|---|---|
| Alabama * | $ 1,021,257 | $ 1,037,650 |
| Arkansas | 236,170 | 279,025 |
| Florida | 399,787 | 506,232 |
| North Carolina | 459,351 | 565,235 |
| Oklahoma | 303,408 | 414,468 |
| TOTALS | $ 2,419,973 | $ 2,802,610 |

*Held for the protection of all policyholders.

The Company included its security on deposit with Oklahoma in the amount listed for Alabama on Schedule E - Part 3 of its 2012 Annual Statement, which was not in accordance with the NAIC *Annual Statement Instructions*. The deposits were confirmed through the use of the custodial confirmations by the external auditors of the Company.

## FINANCIAL CONDITION/GROWTH OF COMPANY

The following information presents significant items that reflect the growth of the Company for the years indicated.

| Year | Admitted Assets | Liabilities | Capital and Surplus | Premiums Earned |
|---|---|---|---|---|
| 2012* | $102,594,476 | $73,239,511 | $ 29,354,965 | $ 37,958,792 |
| 2011 | 94,939,414 | 69,933,849 | 25,005,565 | 39,217,533 |
| 2010 | 96,594,996 | 73,767,855 | 22,827,141 | 40,889,081 |
| 2009 | 88,751,480 | 69,829,241 | 18,922,239 | 40,715,491 |

*Per examination. Amounts for the remaining years were obtained from Company copies of filed Annual Statements. Pending exam change for custodial agreement noncompliance

## LOSS EXPERIENCE

The loss experience as developed by the Company over the examination period is as follows: The following information was obtained from the Company's filed Annual Statements for 2009, 2010, 2011 and 2012.

Life Insurance

| Year | Tabular Cost | Contract Benefits | Reserves Released By Death and Other Terminations |
|---|---|---|---|
| 2009 | $3,132,791 | $2,119,678 | $ 966,027 |
| 2010 | 4,038,557 | 2,060,568 | 966,723 |
| 2011 | 4,470,991 | 2,069,063 | 1,077,402 |
| 2012 | 4,150,520 | 1,837,443 | 1,108,663 |

For each year of the examination period, 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

| Year | Earned Premiums | Incurred Claims | Net Gain From Operations |
|---|---|---|---|
| 2009 | $35,313,650 | $17,336,824 | $3,179,272 |
| 2010 | 35,805,050 | 19,711,901 | 2,736,944 |
| 2011 | 33,707,265 | 19,771,400 | 1,643,884 |
| 2012 | 32,258,847 | 17,102,899 | 1,842,055 |

The incurred claims divided by earned premiums for 2009 was 49.1%, for 2010 was 55.1%, for 2011 was 58.7% and for 2012 was 53.0%, indicating that the Company's accident and health insurance experience has been very good. The net gain from operation for the accident and health business after investment income was added and all expenses and taxes were deducted was positive for each year of the examination period.

## MARKET CONDUCT ACTIVITIES

### Territory

As of December 31, 2012, 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 were issued by the respective states and were reviewed for the period under examination, and no issues were found.

### Plan of Operation

The Company targets groups in rural and urban areas with less than 75,000 population and specializes in selling Health, Accident and Disability insurance and small individual Life policies in Voluntary Payroll Deduction groups. Life of Alabama products are designed for middle-income America. Its product portfolio integrates with other insurance to fill the gap. The benefits are paid directly to the insured during their time of need.

## Underwriting, Policy Forms and Rate Filings

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 and Rate Filings

The Company properly utilized the rates filed and approved by the Alabama Department of Insurance for the examination period under review. 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 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 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 producers and the Company's website. The website provided product information and product descriptions of life insurance and accident and health plans offered by the Company. The Company designs, develops and produces all advertising materials used in the sale of its products. Producer generated sales materials and internet sites are regulated by the Company's Agency/Marketing Department. Producers are required to submit proposed advertising materials or web pages before dissemination to the public.

The Company's advertising materials were reviewed for the examination period. The examiners' review did not reveal any advertisements that misrepresented policy benefits, made unfair or incomplete comparisons with other policies, or made false, deceptive or misleading statements or representations.

## Claims Payment Practices

Paid Claims

A sample of 83 claims was taken from the 2009 through 2012 paid claims listing from an Alabama population total of 618. The sample was reviewed for compliance with policy provisions, timeliness of payments, and adequacy of documentation. There were no discrepancies found within the sample.

Denied Claims

A sample of 82 claims was taken from the 2009 - 2011 denied claims listing from an Alabama population total of 455. A review of the documentation from the sample was made to determine if it supported or justified the ultimate claim determination and if the Company complied with ALA. ADMIN. CODE 482-1-124 (2003). There were no discrepancies found.

## Policyholders' Complaints

During the examination period, there were seven Alabama complaints documented in the Company's complaint register. The Company appropriately maintained the following information in its complaint register: line of business, function and reason for the complaint. The Company's responses fully addressed the issues raised, and the complaints were appropriately resolved within the required timeframe. The Company recorded all complaints, both consumer direct and from the Department of Insurance. Based on the review of the Company's complaint procedures, it was determined that the Company had a sufficient method for the distribution of and obtaining and recording responses to complaints.

## Compliance with Producers' Licensing Requirements

Terminated Producer Reconciliation

The Department's listing included 199 terminated/cancelled producers. The Company's listing contained 158 terminated/cancelled producers. A reconciliation of the Department's listing to the Company's listing was performed. During this reconciliation, it was determined that there were 137 terminated/cancelled producers 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 producers in its listing of producers that was provided to the examiners to review and perform the reconciliation of producers. The Company should maintain a complete and accurate listing of its producers 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 examiner selected a sample of 94 terminated producers to determine compliance with termination notification periods. Only eleven producers in the sample were provided notification of termination in accordance with ALA.CODE § 27-7-30.1(a), which states "(a) Within 15 days after making the notification required by subsection (e) of Section 27-7-30, the insurer shall mail a copy of the notification to the producer at his or her last known address. If the producer is terminated for cause for any of the reasons listed in Section 27-7-19, the insurer shall provide a copy of the notification to the producer at his or her last known address by certified mail, return receipt requested, postage prepaid or by overnight delivery using a nationally recognized carrier." According to a Company official, "The producers were terminated due to lack of production, really no production, or due to their commission check falling below a certain limit. In both of those instances we do not send letters to the producers. ..." The Company was not in compliance with the aforementioned statute.

Appointed Producer Reconciliation

During the reconciliation of the Company's appointed producers listing during the examination period to the Department's listing, it was noted that there were 194 producers listed as appointed by the ALDOI and 288. The Company did not appropriately update its appointed producers' listing that was provided to the examiners to review and perform the reconciliation of producers to the listing maintained by the ALDOI. The Company should maintain a complete and accurate listing of appointed producers, 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 producers' listings on a regular basis in order that the number of terminated, canceled, and appointed producers 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."

## Privacy Policy and Practices

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 due to no disclosure of 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 policyholders receive 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 during the examination period was June 2012. 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's policies, practices and procedures regarding the protection and disclosure of nonpublic personal information of consumers and former customers were in compliance with ALA. ADMIN. CODE 482-1-122.

## REINSURANCE

### Reinsurance Assumed

*Schedule S - Part 1 - Section 1* of the Company's 2012 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 and 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 2012 and the insurance in-force was $1,375,000. 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 $3,779 in assumed premiums during 2012 and the insurance in-force was $1,409,782,000. 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 2012 under the Life reinsurance agreements was $1,181,509. The significant reinsurance agreements in-force were with the following reinsures: 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. 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 | **Amendment # 5 - Effective January 1, 1980**<br>***Ages 0-60:*** 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.<br>***Ages 61:*** Standard - $10,000; Tables A - B retention is $5,000; Tables C - D retention is $2,500; and Table E - P retention None. |
| Reinsurer's limit | ***Ages 0-60:*** Standard -$200,000; Tables A - B $50,000; Tables C - D $25,000; Table E - P $10,000<br>***Ages 61 - 65:*** 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. |
| Reinsurer'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 | **Alphabet A – Z**<br>Whole Life (2004 –WL142)<br>Term (2004 –LT220)<br>Term (2009- LT300) |
| 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 | **Alphabet L – Z**<br>10 years term |
| Effective | July 1, 1991 (Amendment) August 1, 2006 (Amendment) |
| Retention | ***Ages 0 – 60***: Standard thru table 2 - $50,000; Table 3 thru table 6 - $25,000; Table 8 through up, $10,000.<br>***Ages 61 and over***: Standard thru table 2 - $25,000; Table 3 thru table 6 - $10,000; Table 8 through up, $5,000.<br>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**<br>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.<br>***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)<br>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 and Internal Audit and Actuarial services*

Thomas Howell Ferguson, P.A. was the Company's certified public accountants (CPAs) for 2012. Prior to 2012, the Company was audited by Barfield, Murphy, Shank & Smith PC. The examiners reviewed the CPAs workpapers and incorporated these into the examination as deemed appropriate.

Willis, Boatner, and Whiteside, LLC was the Company's internal auditor for 2012.

The Company's reserves were certified by the Company's SVP and Chief Actuary, Steven Keck, FSA, MAAA, for the examination period.

### *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." During the course of the examination, the Company developed and implemented a record retention policy and procedure that was in compliance with ALA. ADMIN. CODE 482-1-118-.03 (1999).

***Information Systems Review***

During an examination of the Company's information systems, the controls governing backup procedures were reviewed. It was determined the Company had entered into an express agreement with a storage company. The agreement allowed the storage company to seize and sell the Company's backups for nonpayment of rent. These backups contain critical business records as well as sensitive policy holder information. Therefore, it was determined the Company was not in compliance with ALA. ADMIN. CODE 482-1-126-.07, which states "Assess Risk. The licensee:

(a) Identifies reasonably foreseeable internal or external threats that could result in unauthorized disclosure, misuse, alteration or destruction of customer information or customer information systems.

(b) Assesses the likelihood and potential damage of these threats, taking into consideration the sensitivity of customer information.

(c) Assesses the sufficiency of policies, procedures, customer information systems and other safeguards in place to control risks."

During a review of the Company's IT Security Contingency Plan, the controls governing testing of the plan were examined. It was determined that the plan had not been tested. Without testing, business management cannot measure the effectiveness or completeness of the plan. Reports of the testing, to include problems identified and fix actions, should be developed by IT and reviewed by business management to ensure the plan is effective and complete. Without annual testing to validate business continuity plans, the Company is at a significantly increased risk that IT restoral plans will fail or provide unacceptable business functionality following an adverse event.

The Company's controls governing project management were reviewed. It was determined that the Company had entered into an informal agreement with another company to develop and maintain a web based multistate policy application system for producer use. While it is not uncommon for businesses to develop and culture relationships with other entities, it is highly uncommon for businesses to enter into relationships whereby significant reliance upon another entity is not first expressly documented and formalized with a legal contract. Without an express contract, the risk that the service provider will default on its obligations or agreements is substantially increased.

***Exhibit of Number of Policies, Contracts, Certificates, Income Payable and Account Values In Force for Supplementary Contracts, Annuities, Accident & Health and Other Policies***

The Company incorrectly reported 710 in force contracts for its Dividend Accumulations Contracts within the Exhibit of Number of Policies, Contracts, Certificates, Income Payable and Account Values In Force for Supplementary Contracts, Annuities, Accident & Health and Other Policies in its 2012 Annual Statement. It should have reported 564 in force contracts. According to a Company official, the total number of participating policies were reported instead of just the number of participating policies that had dividends and coupons set up to accumulate This error had no impact on the Company's 2012 surplus.

***Information Requests***

The Company did not always provide requested information within ten working days, as required by ALA. ADMIN. CODE 482-1-118-.06, 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."

## FINANCIAL STATEMENTS

The financial statements included in this report reflect the financial condition of the Company as of December 31, 2012, and its operations for the years under examination. The statements were presented in the following order.



**THE NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART THEREOF.**

# LIFE INSURANCE COMPANY OF ALABAMA
## STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS
### For the Year Ended December 31, 2012

| | Assets | Nonadmitted Assets | Net Admitted Assets |
|---|---|---|---|
| **ASSETS** | | | |
| Bonds (Note 1) | $ 81,846,593 | $ - | $ 885,740,759 |
| Stocks: | | | |
| Preferred stocks (Note 1) | 19,806 | 656 | 19,150 |
| Common stocks (Note 1) | 4,471,826 | | 4,471,826 |
| Real estate: | | | |
| Properties occupied by the company | 449,088 | 8,379 | 440,709 |
| Properties held for the production of income | 115,383 | 37,209 | 116,174 |
| Cash | 3,182,993 | | 3,182,993 |
| Contract loans | 3,150,380 | | 3,150,380 |
| Other invested assets (Schedule BA) | 2,253,354 | | 2,253,354 |
| Receivables for securities | 15,841 | - | 15,841 |
| Subtotals, cash and invested assets | $ 95,543,264 | $ 46,244 | $ 95,497,020 |
| Investment income due and accrued | $1,163,433 | | $1,163,433 |
| Premiums and considerations: | | | |
| Uncollected agents' balances in the course of collection (Note 2) | 1,184,346 | 758,109 | 426,237 |
| Deferred premiums, agents' balances and installments booked but not deferred and not yet due | 2,320,234 | | 2,320,234 |
| Reinsurance: | | | |
| Amounts recoverable from reinsurers | 45,000 | | 45,000 |
| Other amounts receivable under reinsurance contracts | 299,519 | | 299,519 |
| Net deferred tax asset | 2,820,880 | 1,269,747 | 1,551,133 |
| Electronic data processing equipment and software | 52,311 | | 52,311 |
| Furniture and equipment | 20,622 | 20,622 | 0 |
| Aggregate write-ins for other than invested assets: | | | |
| Cash surrender value corporate owned life insurance | 1,533,153 | | 1,533,153 |
| Agents' credit balances | 13,449 | 13,449 | 0 |
| Loans unsecured | 8,293 | 8,293 | 0 |
| Cash advanced to agents | 200 | 200 | 0 |
| Company automobile | 14,822 | 14,822 | - |
| **TOTALS** | $ 104,725,962 | $ 2,131,486 | $ 102,594,476 |

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

# LIFE INSURANCE COMPANY OF ALABAMA
## STATEMENT OF ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS
### For the Year Ended December 31, 2012

| | | |
|---|---|---|
| **LIABILITIES** | | |
| Aggregate reserve for life contracts | $ | 37,323,504 |
| Aggregate reserve for accident and health contracts | | 21,103,438 |
| Liability for deposit-type contracts | | 1,426,165 |
| Contract claims: | | |
| Life | | 408,114 |
| Accident and health | | 6,687,269 |
| Provision for policyholders' dividends and coupons payable in following calendar year-estimated amounts: | | |
| Dividends apportioned for payment | | 15,224 |
| Coupons and similar benefits | | 8,878 |
| Premiums and annuity considerations for life and accident and health contracts received in advance | | 295,896 |
| Contract liabilities not included elsewhere: | | |
| Other amounts payable on reinsurance | | 2,315 |
| Interest maintenance reserve | | 1,215,523 |
| Commissions to agents due or accrued-accident and health (Note 3) | | 131,790 |
| General expenses due or accrued | | 1,333,982 |
| Taxes, licenses and fees due or accrued, excluding federal income taxes | | 105,595 |
| Unearned investment income | | 505,426 |
| Amounts withheld or retained by company as agent or trustee | | 106,469 |
| Amounts held for agents' account (Note 3) | | 13,449 |
| Remittances and items not allocated | | 341,302 |
| Miscellaneous liabilities: | | |
| Asset valuation reserve | | 1,214,836 |
| Payable for securities | | 547,150 |
| Aggregate write-ins for liabilities | | |
| Employee Appreciation Day Account | | 16,654 |
| Agent Deduction – Scholarship Account | | 760 |
| Bridge Program Account | | 361,939 |
| Rounding | | (1) |
| **Total Liabilities** | $ | 73,239,511 |
| **CAPITAL AND SURPLUS** | | |
| Common capital stock | $ | 1,500,000 |
| Gross paid in and contributed surplus | | 1,810,697 |
| Unassigned funds (surplus) (Note 4) | | 26,762,634 |
| Less treasury stock, at cost: shares common | | 718,366 |
| **Total Surplus** | $ | 27,854,965 |
| **Total Capital and Surplus** | $ | 29,354,965 |
| **TOTAL LIABILITIES, CAPITAL AND SURPLUS** | $ | 102,594,476 |

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

# LIFE INSURANCE COMPANY OF ALABAMA
## SUMMARY OF OPERATIONS
### For the Years Ended December 31, 2012, 2011, 2010, and 2009

| Income | 2012 | 2011 | 2010 | 2009 |
|---|---|---|---|---|
| Premiums and annuity consideration | $37,958,792 | $39,217,533 | $40,889,081 | $40,715,491 |
| Net investment income | 4,068,792 | 4,402,238 | 4,080,362 | 4,190,933 |
| Amortization of IMR | 57,568 | (116,298) | 65,625 | 31,989 |
| **Aggregate write-ins for miscellaneous income** | 72,039 | 47,870 | 120,393 | 70,437 |
| **Total Income** | $42,157,191 | $43,551,343 | $45,155,461 | $45,008,850 |
| **Deductions:** | | | | |
| Death benefits | $ 1,837,443 | $ 2,069,063 | $ 2,060,568 | $ 2,119,678 |
| Annuity benefits | 178,130 | 196,066 | 257,755 | 273,081 |
| Disability benefits and benefits under accident and health contracts | 17,159,145 | 19,978,816 | 19,564,283 | 17,293,156 |
| Coupons, guaranteed annual pure endowments and similar benefits | 9,020 | 9,803 | 9,905 | 16320 |
| Surrender benefits and withdrawals for life contracts | 930,586 | 895,167 | 794,284 | 792,927 |
| Interest and adjustments on contract or deposit-type contract funds | 1,335 | 1,333 | 1,458 | 1,441 |
| Payments on supplementary contracts with life contingencies | | | | 379 |
| Increase in aggregate reserves for life and accident and health contracts | 1,936,402 | 134,125 | 320,461 | 2,631,714 |
| **Totals** | $22,052,061 | $23,284,373 | $23,008,714 | $23,128,696 |
| Commissions on premiums, annuity considerations & deposit-type contract funds (direct business only) | 7,494,988 | 7,574,209 | 8,432,790 | 8,465,785 |
| General insurance expenses | 8,172,770 | 8,233,068 | 8,098,382 | 7,531,307 |
| Insurance taxes, licenses and fees, excluding federal income taxes | 1,046,931 | 1,094,408 | 1,117,755 | 1,099,025 |
| Increase in loading on deferred and uncollected premiums. | (3,404) | (67,785) | 19,850 | 70,147 |
| Aggregate write-ins for deductions | 84,524 | 69,837 | 151,675 | 109,770 |
| **Total deductions** | $38,847,870 | $40,188,110 | $40,829,166 | $40,404,730 |
| Net gain from operations before dividends to policyholders and FIT | $ 3,309,321 | $ 3,363,233 | $ 4,326,295 | $ 4,604,120 |
| Dividend to policyholders | 14,561 | 16,008 | 16,443 | 16,767 |
| Net gain from operations after dividends to policyholders and before FIT | $ 3,294,760 | $ 3,347,225 | $ 4,309,852 | $ 4,587,353 |
| Federal and foreign income taxes incurred | 264,233 | 828,069 | 777,971 | 1,073,732 |
| Net gain from operations after dividends to policyholders and FIT and before realized capital gains or (losses) | $ 3,030,527 | $ 2,519,156 | $ 3,531,881 | $ 3,513,621 |
| Net realized capital gains or (losses) transferred to the IMR) | (13,261) | 541,398 | (1,000) | (202,020) |
| **Net income** | $ 3,017,266 | $ 3,060,554 | $ 3,530,881 | $ 3,311,601 |

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

# LIFE INSURANCE COMPANY OF ALABAMA
## CAPITAL AND SURPLUS ACCOUNT
### For the Years Ended December 31, 2012, 2011, 2010, and 2009

| | 2012 | 2011 | 2010 | 2009 |
|---|---|---|---|---|
| **Capital and surplus, December 31, prior year** | $ 25,005,565 | $ 22,827,141 | $ 18,922,239 | $16,138,432 |
| Net income | 3,017,266 | 3,060,554 | 3,530,881 | 3,311,601 |
| Change in net unrealized capital gains or (losses) | 698,696 | (823,213) | 977,809 | 452,735 |
| Change in net deferred income tax | (781,110) | 166,326 | (268,959) | 618,283 |
| Change in nonadmitted assets and related items | 2,015,815 | (149,656) | 229,298 | (914,843) |
| Change in asset valuation reserve | (384,350) | 93,706 | (359,074) | (516,842) |
| Change in treasury stock | | 8,976 | | |
| Surplus adjustment- paid in | | 37,038 | | |
| Dividend to Stockholders | (216,917) | (215,306) | (205,054) | (167,127) |
| Aggregate write-ins for gains and losses in surplus | - | (1) | 1 | - |
| **Net change in capital and surplus for the year** | $ 4,349,400 | $ 2,178,424 | $ 3,904,902 | $ 2,783,807 |
| **Capital and surplus, December 31, current year** | $ 29,354,965 | $ 25,005,565 | $ 22,827,141 | $18,922,239 |

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

## NOTES TO FINANCIAL STATEMENTS

| | |
|---|---|
| **Note 1- Bonds** | **$81,846,593** |
| **Preferred stocks** | **$ 19,150** |
| **Common stocks** | **$ 4,471,826** |

The above captioned amounts are the same as reported by the Company in its 2012 Annual Statement.

The Company's bonds, preferred and common stocks were held at Stern, Agee & Lynch as of December 31, 2012 under a custodial agreement that was never approved by the Alabama Department of Insurance. ALA. ADMIN. CODE 482-1-077-.04 (o) (2003) states that "The custody agreement is of no force and effect until the Commissioner approves, in writing, the custody agreement." ALA. ADMIN. CODE 482-1-077-.04 (3) (2003)further states "Any securities that are not held in compliance with this chapter shall be not admissible assets for financial reporting purposes." However, during the course of the examination, the Company obtained an approved custodial agreement with U.S. Bank and transferred all of its securities to U.S. Bank under this agreement, and the Company's securities were admitted for the purposes of this examination.

| | |
|---|---|
| **Note 2- Uncollected premiums and agents' balances in the course of collection** | **$426,237** |

The captioned amount is the same as reported by the Company in its 2012 Annual Statement.

The Company did not adopt a formal written cancellation/lapsing policy, which would allow the Company to take appropriate and timely actions to cancel policies and manage potential liability arising from non-cancellation of a policy. This was also noted in the prior examination.

| | |
|---|---|
| **Note 3- Commissions to agents due or accrued** | **$131,790** |
| **Amounts withheld for agents' account** | **$ 13,449** |

The captioned amounts are the same as reported by the Company in its 2012 Annual Statement.

According to the Company's agents' manual, 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. According to a Company official, these amounts are reported within the Amounts withheld for agents' account liability line item, which was not in accordance with the NAIC *Annual Statement Instructions*. According to the NAIC *Annual Statement Instructions* for the Amounts withheld for agents' account liability line item, "Agents' credit balances as well as any other amounts due or contingently due to agents (but not commissions, which should be included in Line 10). Do not offset the debit balance of one agent against the credit balance of another." The $13,449 should have been included within the Commissions to agents due or accrued line item; however, due to the immateriality of this amount and no impact on the Company's surplus, no changes were made to the Company's financials at December 31, 2012.

The $131,790 reported 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 two examinations had also recommended that the Company calculate the commissions on a policy-detail basis.

**Note 4 – Unassigned funds (surplus)** **$26,762,634**

The captioned amount is the same as reported by the Company in its 2012 Annual Statement.

The following schedule presents a reconciliation of the unassigned funds per the Company's filed statement to this examination's findings:

| | | |
|---|---|---|
| Unassigned funds (surplus) per Company | | $26,762,634 |
| Examination increase/(decrease) to assets: | 0 | |
| Total increase/(decrease) to assets | | 0 |
| Examination (increase)/decrease to liabilities: | 0 | |
| Total (increase)/decrease to liabilities | | 0 |
| Unassigned funds (surplus) per Examination | | $26,762,634 |

## 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 auditor's summary of pending litigation as of December 31, 2012. 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.

## COMPLIANCE WITH PREVIOUS RECOMMENDATIONS

A review was conducted during the current examination with regard to the Company's compliance with the recommendations made in the previous examination report. This review indicated that the Company had satisfactorily complied with the prior recommendations with the exception of the following:

Section 1033 OF Title 18 of the U.S. CODE
During the previous examination, it was 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). This examination found that the Company did not do background checks on individuals with whom it contracted with for activities in the business of insurance.

Compliance with Agents' Licensing Requirements

During the previous examination, the following recommendations were made: 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). 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). 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). This examination found the same discrepancies. See "Compliance with Agents' Licensing Requirements" on page 15 for further commentary.

Accounts and Records

The prior examination 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). During the course of the examination, the Company did establish a formal written record retention policy.

The prior examination also recommended that the Company test its disaster recovery plan, which has not been done.

Receivables for securities

During the previous examination, it was recommended that the Company have custodial agreements in place 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." During this examination, it was again noted that the Company did not have a custodial agreement in place. See "Note 1 - Bonds, Preferred stocks, and Common stocks" on page 28.

Uncollected premiums and agents' balances in course of collection

The prior examination recommended that the Company adopt a formal written cancellation/lapsing policy, which would allow the Company to take appropriate and timely actions to cancel policies and manage potential liability arising from non-cancellation of a policy. The Company did not adopt a formal written cancellation/lapsing policy.

Commissions to agents due or accrued
The prior two examinations 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. The Company did not comply with this recommendation.

## COMMENTS AND RECOMMENDATIONS

**Section 1033 OF Title 18 of the U.S. CODE- PAGE 9**

**It is recommended** that the Company establish an internal policy or procedure, by means of background checks, to ensure that those with whom it contracts to do business of insurance with are 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- Page 11**

**It is recommended** that the Company report the statutory deposit held for Oklahoma separately than Alabama on Schedule E - Part 3 in accordance with the NAIC Annual Statement Instructions.

**Compliance with Producers' Licensing- Page 15**

**It is recommended** that the Company comply with ALA.CODE §27-7-30.1(a), which states "(a) Within 15 days after making the notification required by subsection (e) of Section 27-7-30, the insurer shall mail a copy of the notification to the producer at his or her last known address. If the producer is terminated for cause for any of the reasons listed in Section 27-7-19, the insurer shall provide a copy of the notification to the producer at his or her last known address by certified mail, return receipt requested, postage prepaid or by overnight delivery using a nationally recognized carrier."

**It is recommended** that the Company document in its listing all producers 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."

**<u>Accounts and Records</u> – Page 20**

**It is recommended** the Company comply with ALA. ADMIN. CODE 482-1-126-.07, which states "Assess Risk. The licensee: (a) Identifies reasonably foreseeable internal or external threats that could result in unauthorized disclosure, misuse, alteration or destruction of customer information or customer information systems. (b) Assesses the likelihood and potential damage of these threats, taking into consideration the sensitivity of customer information. (c) Assesses the sufficiency of policies, procedures, customer information systems and other safeguards in place to control risks."

**It is recommended** the Company annually test its IT Security Contingency Plan.

**It is recommended** the Company establish written contracts for all IT service providers.

**It is recommended** that the Company correctly report its in force dividend accumulations contracts within its Exhibit of Number of Policies, Contracts, Certificates, Income Payable and Account Values In Force for Supplementary Contracts, Annuities, Accident & Health and Other Policies in accordance with the NAIC *Annual Statement Instructions*.

**It is recommended** that the Company provide requested information within ten days in accordance with 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."

**<u>Bonds, Preferred stocks and Common stocks</u> – Page 28**

**It is recommended** that the Company ensure it has a custodial agreement that has been approved by the Alabama Department of Insurance in place for all securities held by a custodian and follow the requirements in ALA. ADMIN. CODE 482-1-077 (2003).

**<u>Uncollected premiums and agents' balances in the course of collection</u> – Page 28**

**It is again 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.

**<u>Commissions to agents due or accrued and Amounts withheld for agents' account</u>- Page 28**

**It is recommended** that the Company report all commissions owed to agents in Commissions to agents due or accrued in accordance with the NAIC *Annual Statement Instructions.*

**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.

**<u>Subsequent Events</u>- Page 33**

**It is recommended** that the Company's ultimate controlling parties file audited financial statements in accordance with ALA. ADMIN. CODE 482-1-055(Form B) item 8(b).

## SUBSEQUENT EVENTS

A review of events subsequent to the December 31, 2012 examination date was done. The following events were noted:

- Wanda Snyder, VP of Information Systems, retired effective December 31, 2013. Ms. Snyder has not been replaced.
- Effective, December 1, 2013, Alburta Daugette Lowe and Anne Daugette Renfrow each own 33% of the Cestus Properties, LLC and Clarence Daugette, III owns 34%, therefore representing controlling interest for each party. ALA. CODE §27-29-1 states "Control shall be presumed to exist if any person, directly or indirectly owns, controls, holds with the power to vote, or holds proxies representing five percent or more of the voting securities of any other person. This presumption may be rebutted by a showing made in the manner provided by subsection (i) of Section 27-29-4 that control does not exist in fact." An audited financial statement as of the end of their latest fiscal year must be filed in accordance with ALA. ADMIN. CODE 482-1-055(Form B) item 8(b).
- During the course of the examination, the Company's custodial agreement with US Bank was approved, and the Company's investments were moved to US Bank. See "Note 1- Bonds, Preferred stocks and Common stocks" on page 28 for further commentary.
- During the course of the examination, the Company developed and implemented a record retention policy and procedure that was in compliance with ALA. ADMIN. CODE 482-1-118-.03 (1999). See the "ACCOUNTS AND RECORDS" section on page 20 for further commentary.

## CONCLUSION

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

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

In addition to the undersigned, Lori Brock, CFE, examiner; Mora Perkins-Taylor, examiner; Charles Turner, CISA, examiner; Agnes Riggins, examiner; and Sanjeev Chaudhuri, FSA, MAAA, actuarial examiner; all representing the Alabama Department of Insurance, participated in the examination of Life Insurance Company of Alabama.

Respectfully submitted,

Rhonda B Ball

Rhonda B. Ball, CFE
Examiner-in-charge
Alabama Department of Insurance