

REPORT OF EXAMINATION
OF THE
CALIFORNIA LIFE AND HEALTH
INSURANCE GUARANTEE ASSOCIATION
AS OF
JUNE 30, 2014

Filed March 8, 2016

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Los Angeles, California
December 22, 2015

Honorable Dave Jones
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

CALIFORNIA LIFE AND HEALTH INSURANCE GUARANTEE ASSOCIATION

(hereinafter also referred to as the Association) at its home office located at 10780 Santa Monica Boulevard, Los Angeles, California 90025.

SCOPE OF EXAMINATION

The previous examination of the Association was made as of June 30, 2010. This examination covered the period from July 1, 2010 through June 30, 2014. The examination included a review of the Association's practices and procedures, minutes of the Board; Nominating Committee; Executive Committee; Audit Committee and Investment Committee, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of June 30, 2014, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Association's operations were reviewed including the following area that require no further comment: organizational records.

ASSOCIATION HISTORY

The Association was organized on February 10, 1994 by the California State Legislature by merging the Robbins-Seastrand Health Insurance Guaranty Association into the California Life and Health Insurance Guaranty Association. The Association retains the rights, property and obligations of the predecessor associations.

The Association was organized pursuant to, and operates in accordance with, Division 1, Part 2, Article 14.7, Section 1067 of the California Insurance Code. In addition, the Association operates under a Plan of Operation approved by the California Department of Insurance. The purpose of the Association is to provide insolvency insurance for each member insurer and discharge its obligations under its insurance policies and to protect the policyholders against loss arising from the failure of an insolvent member insurer. All companies holding certificates of authority to write life, annuity or health insurance in California automatically become members of the Association.

MANAGEMENT AND CONTROL

The Board of Directors (Board), consisting of eleven representatives from life and health insurance companies, manages the business and affairs of the Association. The Board is currently divided into three classes: one class has four directors serving for a term of three years; a second class has four directors serving for a term of three years; and a third class has three directors serving for a term of three years. The Association notifies and requests written approval from the Insurance Commissioner of the elected Board.

As of June 30, 2014, there were approximately 748 life and health insurance companies that were subject to the California Life and Health Insurance Guarantee Association Act and were therefore members of the Association.

The Association's Plan of Operation provides that the number of Directors shall consist of eleven members. The California Insurance Code Section 1067.06 states that the

number of directors shall consist of not less than nine nor more than 13 member insurers. Following are members of the Board and principal officers of the Company serving at June 30, 2014:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
Michael S. Bula Milwaukee, Wisconsin	Assistant General Counsel and Assistant Secretary Northwestern Mutual Life Insurance Company
Sonya Ekart Lincoln, Nebraska	Associate Counsel Allstate Life Insurance Company
William B. Fisher Springfield, Massachusetts	Consultant Massachusetts Mutual Life Insurance Company
Michael B. Hickey Washington, D.C.	Government Relations Counsel Metropolitan Life Insurance Company
Diana M. Marchesi Washington, D.C.	Director of State Government Affairs, Vice President and Associate General Counsel Transamerica Life Insurance Company
Greg S. Martino Blue Bell, Pennsylvania	Assistant Vice President and State Government Relations Aetna Life Insurance Company
Stephen E. Rahn Fort Wayne, Indiana	Senior Vice President, Associate General Counsel and Head of Public Policy Lincoln National Life Insurance Company
Thomas M. Ronce Newport Beach, California	Vice President, Tax Counsel and Law Department Pacific Life Insurance Company
Barrie B. Stokes Birmingham, Alabama	Senior Legal Officer West Coast Life Insurance Company

Name and Location

Todd R. Thakar
Gold River, California

Nick Thompson
Little Rock, Arkansas

Principal Business Affiliation

Vice President, Government Relations
Prudential Insurance Company of
America

Senior Vice President, Regulatory Affairs
United Healthcare Insurance Company

Principal Officers

Name

Todd R. Thakar
William B. Fisher
Nick Thompson

Title

Chair of the Board
Vice-Chair of the Board
Secretary/Treasurer

Management Agreements

Professional Service Agreement: Effective August 1, 1998, the Association entered into a Professional Service Agreement with Guarantee Association Administration, LLC (the Administrator), a Delaware Limited Liability Company, to manage the affairs of the Association. Under the terms of the Agreement, the Association incurred expenses in the amount of \$323,400 per year in fiscal years 2011, 2012, 2013, and 2014.

The Administrator performs all services as delegated by the Association's Board of Directors (the Board). Services that are performed include: maintain office, handle communications, record keeping, filing, storage, assessments of the member companies, administration of claims, communication with National Organization of Life and Health Insurance Guaranty Associations (NOLHGA), attend NOLHGA task force meetings, monitor insolvencies of the member companies, communicate with the Board, and maintain the needed systems and employees to handle all affairs of the Association as an independent contractor. The Association pays monthly fees of \$26,950 for

services rendered by the Administrator. The Association itself has no employees. Personnel servicing the Association are provided by the Administrator.

Third Party Administrator: The Association is party to Third Party Administrator Agreements signed by NOLHGA with various claims administrators who collect premiums of life, health and annuity contracts for liquidations assigned to the Association. The third party administrators used by the Association as of June 30, 2014 are as follows:

Third Party Administrator	Line of Business	Insurance Company & its affiliate
Insurance Administrative Solutions, LLC	Life	Booker T. Washington Insurance Company, Inc. Universal Life Insurance Company
Special Deputy Receiver of Lincoln Memorial Life Insurance Company	Life	Lincoln Memorial Life Insurance Company National Prearranged Services, Inc.

TERRITORY AND PLAN OF OPERATION

Insurance companies writing life and health insurance business in California [certain companies are specifically exempted pursuant to California Insurance Code (CIC) Section 1067.04(i) (1 through 8)] are required to participate in the California Life and Health Insurance Guarantee Association. If an admitted life and health insurance company becomes insolvent, the Association administers covered policyholder claims and assesses each life and health insurance company up to 2% of written premium in the appropriate line of business. CIC Section 1067.08 allows member insurers to surcharge policies to recover health insurance account assessments.

The Association has the responsibility to pay and discharge covered claims of member insurers as of the date a court of competent jurisdiction declares such insurer insolvent and a liquidator is appointed. Covered claims primarily include the policy obligations of insolvent insurers arising from life, health, annuity, and supplemental policies and contracts coverage (exclusive of those lines not included per CIC Section 1067.02).

The Association allocates its claim payments and costs, incurred or estimated to be incurred, to one or more of the following categories: (a) life claim; (b) annuity contracts, and (c) health claims. Separate premium charges (assessments) are required for each category. The assessments from each category are used to pay the claims and costs allocated to that category.

CIC Section 1067.02 establishes that the benefits for covered life and annuity claims are limited to the lesser of: (1) eighty percent of the contractual obligations for each policy or contract; or (2) \$250,000 of the present value of an annuity contract, \$100,000 of cash surrender value of a life insurance policy, or \$300,000 in life insurance death benefits. Coverage is determined after adjusting the policy or contract interest crediting rate for the four years before the member insurer becomes impaired or insolvent so that the rate does not exceed the rate of interest determined by subtracting two percentage points from the average Moody's Corporate Bond Yield Average for that same four-year period. On and after the date on which the member insurer becomes impaired or insolvent, the rate credited on the policy or contract going forward shall not exceed the rate of interest determined by subtracting three percentage points from the most recently available Moody's Corporate Bond Yield Average, but such rate credited shall not go below a minimum rate of 0 percent.

When a life and health insurance company becomes insolvent, the control of its assets transfers to the state insurance liquidator in its domiciliary state. The liquidator uses the assets of the insolvent insurance company to settle the outstanding liabilities of the company. Liquidators may advance estate distributions to the Association prior to settlement of the insolvent insurance company's outstanding debts. The Association

recognizes these advances as revenue when received. The advances are utilized to discharge claims against the insolvent insurance companies. The respective liquidator can recall these advances, in whole or in part. The Association recognizes any recall of advances when notified by the liquidator or receiver.

To the extent that assets, including advances from liquidators, are insufficient to discharge the Association's obligations, the Association assesses member insurers when determined necessary by the Board. Conversely, to the extent the assets exceed the ultimate cost of claim obligation for insolvent insurers, the excess fund balance, if any, will be refunded or applied to reduce future assessments by the Association in the appropriate category.

Assessments are accrued as of the date declared by the Board and become due from the member insurers no less than thirty days after assessed. The rate of assessment to each member insurer is initially based on the average written premium for the three years preceding the insolvency, as shown on the annual financial statements filed with the California Insurance Commissioner, as adjusted by exclusions pursuant to the CIC section 1067.02.

As of June 30, 2014, the Association continues to satisfy its statutory obligations to contract-holders for 38 insolvent insurers both active and inactive. For the year ended June 30, 2014, the Association paid out approximately \$529 thousand in direct benefits, primarily for life insurance death benefits related to Lincoln Memorial Life Insurance Company. During the same period, the Association paid approximately \$17.6 million for benefits through an agreement of restructuring that related to the Executive Life Insurance Company of New York's insolvency.

REINSURANCE

Traditional reinsurance, entered into by member insurers prior to their insolvencies, is administered by the liquidator of the insolvent member insurer and is therefore excluded from the Association's financial statements. Reinsurance recoveries made by the liquidator may be advanced to the Association subject to the priority needs of the estate in liquidation. Ancillary liquidations may also have a demand on assets recoverable, including reinsurance recoverables and special and statutory deposits. Under CIC section 1067.07(o), upon a liquidation or rehabilitation order, the Association may elect to succeed to the insolvent member insurer's reinsurance contract for which the Association has underlying coverage obligations. To do so, the Association must pay all the unpaid premiums due under the reinsurance contract due before and after the liquidation or rehabilitation order.

INVOLVEMENT WITH INSOLVENT INSURERS

Since its inception, the Association has been responsible for the payment of benefits to California policyholders and contract holders of the following insolvent member insurance companies:

<u>Insolvency</u>	<u>Year Activated</u>
Great Republic Insurance Company	1991
Midwest Life Insurance Company	1991
Legacy Life Insurance Company	1991
Executive Life Insurance Company	1991
Fidelity Bankers Life Insurance Company	1992
Investment Life Insurance Company of America	1993
Inter-American Insurance Company of Illinois	1991
Mutual Security Life Insurance Company	1991
New Jersey Life Insurance Company	1993
American Integrity Insurance Company	1993

Mutual Benefit Life Insurance Company	1994
Old Colony Life Insurance Company	1994
Consumers United Insurance Company	1994
Kentucky Central Life Insurance Company	1994
Summit National Life Insurance Company	1994
Confederation Life Insurance Company (U.S.)	1994
National American Life Insurance Company of PA	1995
Supreme Life Insurance Company of America	1995
American Western Life Insurance Company	1997
Centennial Life Insurance Company	1998
Universe Life Insurance Company	1998
Statesman National Life Insurance Company	1999
First National Life Insurance Company of America	1999
International Financial Services Life Insurance Company	1999
American Chambers Life Insurance Company	2000
Combined Benefits Insurance Company	2000
Reliance Insurance Company	2001
Legion Insurance Company	2003
Villanova Insurance Company	2003
London Pacific Life and Annuity Company	2004
Lincoln Memorial Life Insurance Company	2008
Medical Savings Insurance Company	2009
Imerica Life and Health Insurance Company	2010
Universal Life Insurance Company	2010
Golden State Mutual Life Insurance Company	2011
Standard Life Insurance Company of Indiana	2012
Executive Life Insurance Company of New York	2013
Lumbermens Mutual Casualty Company	2013

The Association has been monitoring other member insurance companies presently in conservation and rehabilitation where the Association may, at some time in the future,

incur liability for benefit payments to California policyholders and contract holders.
Companies in this category include:

Fremont Life Insurance Company

Monarch Life Insurance Company

Penn Treaty Network America Insurance Company

American Network Insurance Company

FINANCIAL STATEMENTS

The following financial statements are based on the Annual Reports filed by the Association with the California Department of Insurance and present the financial condition of the Company for the period ending June 30, 2014.

Balance Sheet as of June 30, 2014

Statement of Activities for the Year Ended June 30, 2014

Statement of Changes in Members' Net Assets for the Years ended June 30, 2011 to June 30, 2014

Statement of Cash flows for the Year Ended June 30, 2014

Balance Sheet
as of June 30, 2014

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Cash and cash equivalents	\$ 6,926,114	\$ 6,926,114	(1)
Investments	13,497,135	13,497,135	
Assessments receivable:			
Called, net of allowance for uncollectible balances Of \$708,524	13,010	13,010	(2)
Declared, but not yet called	20,443,799	20,443,799	(2)
Other assets	<u>305,408</u>	<u>305,408</u>	
Total assets	<u>\$ 41,185,466</u>	<u>\$ 41,185,466</u>	
<u>Liabilities and Members' Net Assets</u>			
Reserves for obligations to policyholders of impaired and/or insolvent insurers and administrative expenses		\$ 12,382,159	(3)
Assessment refunds due to members		3,561	
Other liabilities		<u>631,720</u>	
Total liabilities		13,017,440	
Members' net assets		<u>28,168,026</u>	
Total liabilities and members' net assets		<u>\$ 41,185,466</u>	

Statement of Activities
for the Year Ended June 30, 2014

Revenue

Assessments declared	\$	0
Premium		81,785
Early access distributions from liquidators		160,750
Interest income, less expense of \$17,351		<u>(7,286)</u>

Total revenue	<u>235,249</u>
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Expenses

Claims and claims handling:		
Benefits paid	\$	529,355
Assumption reinsurance payments, net		17,618,669
Change in reserves for obligations to policyholders		
Of impaired and/or insolvent insurers		<u>(18,382,841)</u>

Total claims and claims handling	<u>\$ (234,817)</u>
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Legal and professional	1,863,527
Accounting and auditing	41,655
NOLHGA taskforce expenses and membership dues	1,126,371
Travel	74,535
Uncollectible member assessments	943
General and administrative	43,444
Professional services contract	<u>323,400</u>

Total expenses including claims and claims handling	<u>\$ 3,239,058</u>
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Change in members' net assets	<u><u>\$ (3,003,809)</u></u>
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Statement of Changes in Members' Net Assets for
the Years Ended June 30, 2011 to June 30, 2014

	<u>Total Members' Net Assets</u>
Member's Net Asset, July 1, 2011	2,817,382
Changes in members' net assets	<u>1,278,330</u>
Balance, June 30, 2012	4,095,712
Changes in members' net assets	49,701,652
Distribution to members of assessments declared but not called	<u>(22,625,529)</u>
Balance, July 1, 2013	31,171,835
Changes in members' net assets	<u>(3,003,809)</u>
Members' Net Asset, June 30, 2014	<u>\$ 28,168,026</u>

Statement of Cash Flows
for the Year Ended June 30, 2014

	<u>For the Year Ended June 30, 2010</u>
<u>Assets</u>	
Cash flows from operating activities:	
Cash received from member company assessments	\$ 21,803,808
Cash received from policy premiums	81,785
Cash received for early access distributions	160,750
Interest received, net of investment expenses	(9,387)
Cash paid for policyholder obligations	(18,179,908)
Cash paid for consultants and suppliers	<u>(631,058)</u>
Net cash provided by operating activities	<u>3,225,990</u>
Cash flows from investing activities:	
Cash received from sale of investments	24,740,840
Cash paid for purchases of investments	<u>(38,237,975)</u>
Net cash provided by operating activities	<u>(13,497,135)</u>
Net decrease in cash and cash equivalents	(10,271,145)
Cash and cash equivalents at beginning of year	<u>17,197,259</u>
Cash and cash equivalents at end of year	<u>\$ 6,926,114</u>
Reconciliation of change in members' net assets to net cash used in operating activities:	
Change in members' net assets	\$ (3,003,809)
Adjustments to reconcile change in members' net assets to net cash from operating activities:	
Reserves for obligations to policyholders	
Impaired and/or insolvent insurers and administrative expenses	(18,382,841)
Decrease (increase) in:	
Assessments receivable	21,803,533
Other assets	2,328,522
Increase (decrease) in:	
Assessments refunds due to members	1,218
Other liabilities	<u>479,367</u>
Net Cash Used In Operating Activities	<u>\$ 3,225,990</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Cash and Short-Term Investments

The Association's investment policy is to limit its portfolio to investment in United States (U.S.) Government, and U.S. government agencies instruments with maturities not to exceed 90 days. The Association maintains its cash in a federally insured banking institution with a total account balance of \$6,926,114 as of June 30, 2014.

(2) Assessments Receivable

There are two classes of assessments to member companies. Class A assessments are made for the purpose of meeting general and administrative expenses. Class B assessments are necessary to discharge the duties of the Association to California resident policyholders due to a particular insolvency. Class B assessments are shared by member companies in the proportion to average premiums written in California for each line of business (life, annuity, and health) for the past three years prior to the year of liquidation. The assessment to each member may not exceed 2% of the members' three-year average premiums. To the extent the assessment exceeds the cost of insolvency; the assessment may be refunded to the members.

Assessment receivable: Called, net of allowance for uncollectable balances, was \$13,010 which was primarily for Monarch Life Insurance Company and Fremont Life Insurance Company.

Assessments receivable: Declared, but not yet called, of \$20,443,799 was comprised of \$16,499,999 for Lincoln Memorial Life Insurance Company, \$3,000,000 for Medical Savings Insurance Company and \$943,800 for Kentucky Central Life Insurance Company.

During the fiscal year ending June 30, 2014, the Association did not declare a Class A (administrative) assessment, nor was there a Class B assessment called or declared.

Assessments are recorded when declared by the Association. The Board will call the declared assessment as needed, at which time it is payable by member companies. The assessments called and not collected by the Association are booked net of an allowance for uncollectable assessments from insolvent or impaired companies.

(3) Reserves for Obligations to Policyholders of Impaired and/or Insolvent Insurers and Administrative Expenses

The carried reserves are based on estimates provided by the state insurance liquidators and verified by the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) task forces (who rely on the work of retained actuaries and consultants) on behalf of various state guaranty associations. The reserves are actuarial estimates based on underlying data maintained by various state insurance liquidators, reinsurers, or third parties. This information is not always available or reliable for an accurate estimate for future obligations. For this reason, it is not practical for the examiner to extend procedures sufficiently to validate the data nor is it cost effective to have additional actuarial studies performed pursuant to the examination to determine reserve accuracy. Therefore, the examination was limited-in-scope as regards to the procedures used to verify the Association's reserves for obligations to policyholders of impaired and or insolvent insurers and administrative expenses, estimated at \$12 million. The examiner relied on estimates without testing, as provided by the state insurance liquidators and as verified by NOLGHA's task forces.

As of June 30, 2014, the Executive Life reserve is estimated at \$1.5 million or approximately 12% of the total reserves for policyholder obligations recognized by the Association, and is based on an enhancement agreement with Aurora National Life Insurance Company (Aurora). Pursuant to the enhancement agreement, Aurora acquired certain insurance contracts from Executive Life Insurance Company and, in

return, most state guaranty associations, including the Association, make contributions to fund their obligations under the enhancement agreement. On May 30, 2013, the Association defeased substantially all of its remaining obligations with Aurora under the enhancement agreement for a payment of \$106 million.

The Lincoln Memorial Life Insurance Company (Lincoln Memorial) reserve at \$10 million, or approximately 80% of the total Association reserves for policyholder obligations, is approximately equal to the Association's remaining obligation in relation to the face value of life insurance policies owned by California residents.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

None.

Previous Report of Examination

Management and Control – Conflict of Interest (Page 4): As the result of the review of the Association's conflict of interest policy, it was determined that a representative of one of the directors did not timely sign the conflicts of interest statement. The Association requested that all officers and directors sign and return the conflicts of interest statement in timely manner. The officers and directors have complied.

ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Association's officers and employees during the course of this examination.

Respectfully submitted,

____/S/_____

Millie Cao, CFE
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California

____/S/_____

Aram Shahenian, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California