

REPORT OF EXAMINATION
OF THE
PORTUGUESE FRATERNAL SOCIETY OF AMERICA
AS OF
DECEMBER 31, 2014

A handwritten signature in black ink that reads "Dave Jones". The signature is written in a cursive style with a large, looping initial "D".

Insurance Commissioner

FILED 2-8-16

TABLE OF CONTENTS

	<u>PAGE</u>
SCOPE OF EXAMINATION	1
SOCIETY HISTORY.....	2
MANAGEMENT AND CONTROL	3
TERRITORY AND PLAN OF OPERATION.....	4
REINSURANCE:	5
Assumed.....	5
Ceded	5
ACCOUNTS AND RECORDS.....	5
FINANCIAL STATEMENTS:	6
Statement of Financial Condition as of December 31, 2014	7
Summary of Operations and Surplus Account for the Year Ended December 31, 2014	8
Reconciliation of Surplus from December 31, 2010 through December 31, 2014	9
COMMENTS ON FINANCIAL STATEMENT ITEMS:.....	10
Bonds.....	10
Aggregate Reserve for Life Certificates Contracts	10
Aggregate Reserve for Accident and Health Contracts.....	10
Liability for Deposit-Type Contracts	10
SUMMARY OF COMMENTS AND RECOMMENDATIONS:	10
Current Report of Examination	10
Previous Report of Examination.....	11
ACKNOWLEDGMENT	13

San Francisco, California
November 17, 2015

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

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

PORTUGUESE FRATERNAL SOCIETY OF AMERICA

(hereinafter also referred to as the Society) at its home office located at 1120 East 14th Street, San Leandro, California 94577.

SCOPE OF EXAMINATION

We have performed our single state examination of the Society. The previous examination of the Society was as of December 31, 2010. This examination covered the period from January 1, 2011 through December 31, 2014.

The examination was conducted in accordance with the National Association of Insurance Commissioners *Financial Condition Examiners Handbook (Handbook)*. The Handbook requires the planning and performance of the examination to evaluate the Society's financial condition, assess corporate governance, identify current and prospective risks, and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Society were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately following the Society's financial statements.

This examination report includes findings of fact and general information about the Society and its financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), were not included within the examination report but separately communicated to other regulators and/or the Society.

SOCIETY HISTORY

The Society is a not-for-profit corporation formed, organized, and incorporated under the Fraternal Benefit Society Laws of the State of California for the sole mutual benefit of its members and their beneficiaries. The Society operates on the lodge system, with ritualistic ceremonies and a representative form of government.

Effective January 1, 2010, the Society became the surviving entity in a four-way merger with Irmandade do Divino Espirito Santo (I.D.E.S.); Sociedade do Espirito Santo (S.E.S.); and the Uniao Portuguesa Protectora do Estado da California (U.P.P.E.C.). As a result of the merger, the Society changed its name from Uniao Portuguesa do Estado da California (U.P.E.C.) to Portuguese Fraternal Society of America.

MANAGEMENT AND CONTROL

Management of the Society is vested in a seven-member Business Board of Directors. Directors serve in staggered terms with one director's term expiring and standing for election each year. Following are members of the board and principal officers of the Society serving at December 31, 2014:

Directors

<u>Name and Location</u>	<u>Principal Business Affiliation</u>
John A. R. Salvador ^(a) Patterson, California	Funeral Counselor and Office Manager Hillview Funeral Chapels
Marie B. Kelly-Barreiro Turlock, California	Certified Public Accountant Marie B. Kelly & Associates
Robert A. Bertao Dos Palos, California	Farmer
Gary C. Meyer Tracy, California	Retired
Duane S. Oliveira Benicia, California	Owner Oliveira Law Firm
Joe A. Pimentel Sunnyvale, California	Retired
Donald D. Valadao ^(b) San Diego, California	Controller Cement Cutting, Inc.

Principal Officers

<u>Name</u>	<u>Title</u>
Gary J. Rohrbaugh ^(a)	Chief Executive Officer
Helen D. Vieira	Executive Treasurer and Chief Financial Officer
Carla F. Cardoso	Executive Secretary

(a) The Board of Directors did not renew Gary Rohrbaugh's contract as the Chief Executive Officer (CEO) of the Society effective September 1, 2015. John Salvador resigned as the Chairman of the Board and became the CEO effective November 2, 2015.

(b) Donald Valadao became the Chairman of the Board effective November 2, 2015.

TERRITORY AND PLAN OF OPERATION

The Society operates under the lodge system as described under Division 2, Part 2, Chapter 10, of the California Insurance Code. The Society is licensed to transact life, annuity, and disability business in California, Nevada, and Rhode Island. The Society has sixty-five subordinate councils in California, one subordinate council in Nevada, one subordinate council in Massachusetts, and one subordinate council in Rhode Island. Since 2010, the Society merged councils within the same cities in California which reduced the number of California councils from one hundred and twenty-one to sixty-five.

The Society has four classes of members: benefit, social, youth and honorary. Any person in good health between birth and 80 years of age is eligible to be an insured member. Juveniles at any age through 15 may join, but do not have voting rights in the Society's management until they reach age 16. Social members are those who apply for social membership through the subordinate council. These members are only entitled to participate in the social activities of the local subordinate council. Honorary members are persons considered of great distinction to the Society.

As of December 31, 2014, the Society employed 19 (ten full time and nine part time) agents, also known as membership representatives. All of the Society's businesses are produced by these membership representatives.

In 2014, 99.2% of premiums and annuity considerations totaling \$3,761,621 were written in California. All business operations are performed at the Society's home office located in San Leandro, California.

REINSURANCE

Assumed

The Society did not assume reinsurance during the examination period.

Ceded

Effective January 1, 2002, the Society entered into an Automatic Reinsurance Agreement (Agreement) with Optimum Re Insurance Society of Dallas, Texas, an admitted insurer in California. Effective November 15, 2014, the Agreement was amended which changed this Agreement into a facultative reinsurance agreement with the Society's retention limit per life at \$250,000 and the facultative reinsurance limit per life at \$10,000,000.

ACCOUNTS AND RECORDS

During the course of the examination, a review was made of the Society's general controls over its information systems. As a result of this review, some findings were noted and were presented to the Society along with recommendations to strengthen its controls. The Society should evaluate the recommendations and make appropriate changes to strengthen its information systems controls.

FINANCIAL STATEMENTS

The following financial statements are based on the statutory financial statements filed by the Society with the California Department of Insurance and present the financial condition of the Society for the period ending December 31, 2014. There were no examination adjustments as a result of the examination.

Statement of Financial Condition as of December 31, 2014

Summary of Operations and Surplus Account for the Year Ended
December 31, 2014

Reconciliation of Surplus from December 31, 2010 through December 31, 2014

Statement of Financial Condition
as of December 31, 2014

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Bonds	\$ 79,947,560	\$	\$ 79,947,560	(1)
Preferred stocks	7,471,798		7,471,798	
Common stocks	2,284,075		2,284,075	
Mortgage loans on real estate	7,273,195		7,273,195	
Real estate – Properties occupied by the Society	157,418		157,418	
Real estate – Properties held for the production of income	2,424,442		2,424,442	
Cash, cash equivalent, and short-term investments	11,439,082		11,439,082	
Contract Loans	362,227		362,227	
Investment income due and accrued	1,404,028		1,404,028	
Deferred premiums, agents' balances and installments booked and not yet due (including \$0 earned but unbilled premiums)	9,467		9,467	
Electronic data processing equipment and software	16,123	16,123	0	
Furniture and equipment	596	596	0	
Aggregate write-ins for other than invested assets	<u>38,220</u>	<u>38,220</u>	<u>0</u>	
 Total assets	 <u>\$ 112,828,231</u>	 <u>\$ 54,939</u>	 <u>\$ 112,773,292</u>	
 <u>Liabilities, Surplus and Other Funds</u>				
Aggregate reserve for life certificates and contracts			\$ 95,108,019	(2)
Aggregate reserve for accident and health contracts			196,990	(2)
Liability for deposit-type contracts			1,812,853	(2)
Contract claims: Life			173,625	
Premiums and annuity considerations for life and accident and health received in advance			138,984	
Contract liabilities not included elsewhere: Interest Maintenance Reserve			3,824,144	
General expenses due or accrued			204,865	
Amounts withheld or retained by Society as agent or trustee			79,201	
Miscellaneous liabilities: Asset valuation reserve			2,177,947	
Aggregate write-ins for liabilities			<u>33,456</u>	
 Total liabilities			 103,750,084	
 Unassigned funds (surplus) Surplus		 <u>9,023,208</u>	 <u>9,023,208</u>	
 Total liabilities, surplus and other funds			 <u>\$ 112,773,292</u>	

Summary of Operations and Surplus Account
for the Year Ended December 31, 2014

Summary of Operation

Premiums and annuity considerations for life and accident and health contracts	\$ 3,670,540	
Net investment income	5,574,766	
Amortization of Interest Maintenance Reserve	753,835	
Aggregate write-ins for miscellaneous income	<u>11,271</u>	
 Totals		 10,010,412
 Deductions:		
Death benefits	451,331	
Matured endowments	78,033	
Annuity benefits	3,536,324	
Disability benefits and benefits under accident and health contracts	3,100	
Surrender benefits and withdrawals for life contracts	455,680	
Interest and adjustments on contract or deposit-type contract funds	2,353,456	
Increase in aggregate reserve for life and accident and health contracts	(161,981)	
Commissions on premium, annuity considerations and deposit-type contract funds	33,395	
General insurance expenses and fraternal expenses	1,719,957	
Insurance taxes, licenses and fees	<u>73,153</u>	
 Total deductions		 <u>8,542,448</u>
 Net gain from operations before refunds to members		 1,467,964
 Net realized capital gain		 <u>205,127</u>
 Net income		 <u>\$ 1,673,091</u>

Surplus Account

Surplus, December 31, 2013	\$ 7,606,694
Net income from operations	1,673,091
Change in net unrealized capital losses	(122,279)
Change in nonadmitted assets	(3,331)
Change in asset valuation reserve	<u>(130,967)</u>
 Net change in surplus for the year	 <u>1,416,514</u>
 Surplus, December 31, 2014	 <u>\$ 9,023,208</u>

Reconciliation of Surplus
from December 31, 2010 through December 31, 2014

Surplus, December 31, 2010			\$ 6,547,465
	<u>Gain in Surplus</u>	<u>Loss in Surplus</u>	
Net income from operations	\$ 2,534,509	\$	
Change in net unrealized capital gains/losses		65,245	
Change in nonadmitted assets	86,902		
Change in asset valuation reserve	<u> </u>	<u>80,423</u>	
Total gains and losses	<u>\$ 2,621,411</u>	<u>\$ 145,668</u>	
Net increase in surplus			<u>2,475,743</u>
Surplus, December 31, 2014			<u>\$ 9,023,208</u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds

The Society had \$11.5 million in investment securities on deposit with Morgan Stanley as of December 31, 2014. Morgan Stanley is not an approved custodian and the Society does not have an approved custodial agreement with Morgan Stanley as required pursuant to California Insurance Code (CIC) Section 1104.9. A similar finding was made in the prior report of examination. It is recommended the Society comply with CIC Section 1104.9.

(2) Aggregate Reserve for Life Certificates Contracts; Aggregate Reserve for Accident and Health Contracts; Liability for Deposit-Type Contracts

A Life Actuary from the California Department of Insurance performed an actuarial evaluation of the Society's above captioned reserves as of December 31, 2014. Based on the evaluation, the Society's reserves as of December 31, 2014 were found to be reasonably stated and have been accepted for purposes of this examination.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Accounts and Records (Page 5): As a result of the review of the Society's information systems controls, recommendations for improving these controls were presented to the Society. The Society should evaluate these recommendations and make appropriate changes to strengthen its controls over its information systems.

Previous Report of Examination

Management and Control – Code of Conduct (Page 4): It was recommended that the Society implement procedures to annually obtain and review completed Conflict of Conduct statements for all directors and key employees on an annual basis. The Society has updated its Code of Conduct to require annual disclosure of conflict of interest from its board of directors and employees.

Corporate Records (Page 5): It was recommended the Society comply with California Insurance Code (CIC) Section 735 and inform its board of such receipt of examination reports. The Society has complied with this recommendation.

Territory and Plan of Operation (Page 5): It was recommended that the Society prepare a written five-year strategic plan with forecasts, budgets and yearly updates. The Society has complied with this recommendation.

Accounts and Records (Page 6): It was recommended the Society exercise due care when preparing the annual statements and maintain adequate financial statement documentation to support all reported information. The Society has complied with this recommendation.

Accounts and Records – Information Systems Control (Page 7): It was recommended that the Society evaluate the general control recommendations and make appropriate changes to strengthen its information system controls. The Society has partially complied with this recommendation.

Comments on Financial Statement Items – Bonds (Page 12): It was recommended the Society deposit its securities with a qualified custodian pursuant to CIC Section 1104.9 and discontinue its practice of depositing securities with its investment broker. The Society has not complied with this recommendation.

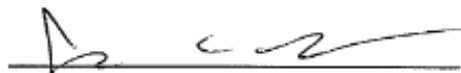
Comments on Financial Statement Items – Bonds (Page 12): It was recommended that the Society draft an investment advisory agreement with Morgan Stanley in accordance with California Department of Insurance advisory, management and service agreement guidelines. The Society has complied with this recommendation.

Comments on Financial Statement Items – Surplus (Page 13): It was recommended the Society exercise due care when preparing the annual statements and maintain adequate financial statement documentation to support all reported information. The Society has complied with this recommendation.

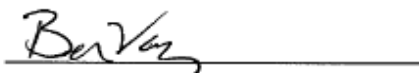
ACKNOWLEDGMENT

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

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Jack Lee', written over a horizontal line.

Jack Lee, CFE
Examiner-In-Charge
Associate Insurance Examiner
Department of Insurance
State of California

A handwritten signature in black ink, appearing to read 'Ber Vang', written over a horizontal line.

Ber Vang, CFE
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California