# REPORT OF EXAMINATION
# OF THE

# BALBOA LIFE INSURANCE COMPANY

AS OF
DECEMBER 31, 2008

Participating State
and Zone:

California

Filed June 29, 2010

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Los Angeles, California
May 28, 2010

Honorable Alfred W. Gross
Chairman of the NAIC Financial
Condition Subcommittee
Commissioner of Insurance
Virginia Bureau of Insurance
Richmond, Virginia

Honorable Christina Urias
Secretary, Zone IV-Western
Director of Insurance
Arizona Department of Insurance
Phoenix, Arizona

Honorable Steve Poizner
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman, Secretary, and Commissioner:

Pursuant to your instructions, an examination was made of the

BALBOA LIFE INSURANCE COMPANY

(hereinafter also referred to as the Company) at its statutory home office and the primary location of its books and records, 3349 Michelson Drive, Suite 200, Irvine, California 92612.

## SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2005. This examination covers the period from January 1, 2006 through December 31, 2008. The examination was made pursuant to the National Association of Insurance Commissioners' plan of examination. The examination included a review of the Company's practices and procedures, 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 December 31, 2008, as deemed necessary under the circumstances.

The examination was conducted concurrently with the examinations of the Company's affiliates, Balboa Insurance Company and Meritplan Insurance Company, and with the Arizona Department of Insurance's examination of the Company's affiliate, Newport Insurance Company.

In addition to those items specifically commented upon in this report, other phases of the Company's operations were reviewed including the following areas that require no further comment: corporate records; fidelity bonds and other insurance; officers', employees', and agents' welfare and pension plans; growth of company; business in force by states; mortality and loss experience; and sales and advertising.

## COMPANY HISTORY

On February 26, 2008, Bank of America Corporation (BAC), a publicly traded company on the New York Stock Exchange and incorporated in the State of Delaware, filed a Form A application with the California Department of Insurance (CDI) pursuant to California Insurance Code (CIC) Section 1215.2 seeking approval to acquire control of the Company, and its affiliates, Balboa Insurance Company (BIC), Meritplan Insurance Company (MIC), and Newport Insurance Company. The CDI approved the Form A application on June 16, 2008.

On July 1, 2008, BAC acquired the Company's former ultimate parent, Countrywide Financial Corporation (CFC), a publicly traded company incorporated in the State of Delaware, thereby becoming the Company's ultimate parent. On November 7, 2008, Effinity Financial Corporation (EFC) acquired all 25,000 shares of the Company's stock from its previous parent, Balboa Insurance Group, Inc. (BIG), a California holding company. On April 27, 2009, EFC was merged into NB Holdings Corporation and the Company was transferred within the BAC organization structure from EFC to BA Insurance Group, Inc.

The Company owns 100% of the outstanding stock of Balboa Life Insurance Company of New York, and also owns one share of stock out of 25,000 issued and outstanding shares of BIC.

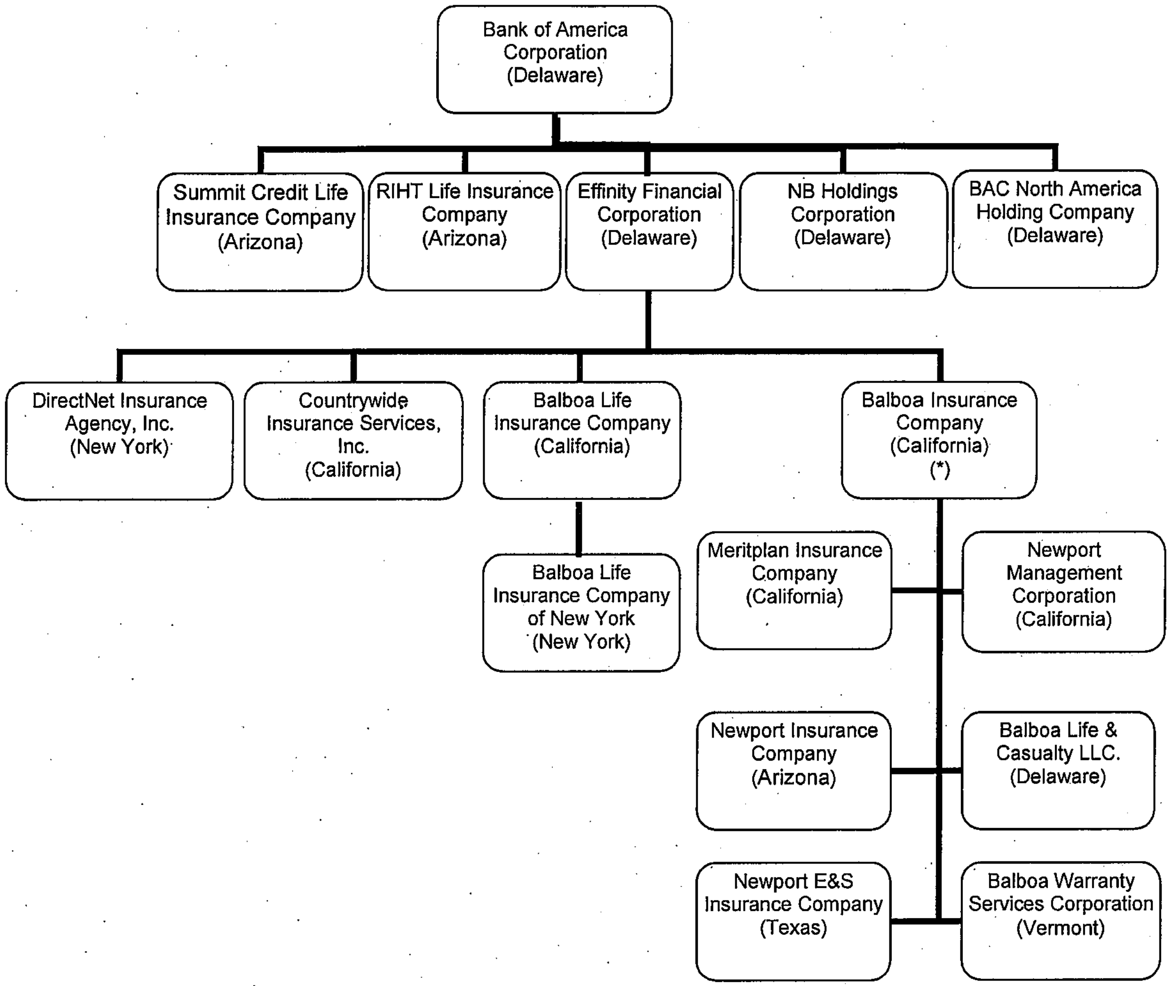
In September 2006, the Company paid a $30 million extraordinary distribution to its immediate parent, BIG. $15 million was a dividend from its unassigned surplus and the remaining $15 million was a distribution from its gross-paid in and contributed surplus. The distribution was made from its gross-paid in and contributed surplus to reduce the Company's capital structure to coincide with its current business model. The extraordinary dividend was approved by the CDI on September 21, 2006 pursuant to CIC Section 10530. At the same time, BIG contributed $30 million in cash and securities to BIC who, in turn, contributed $30 million in cash and securities to MIC.

On January 11, 2008, the Company made a capital contribution of $1.7 million to its subsidiary, Balboa Life Insurance Company of New York. The capital contribution was made under the provisions of CIC Section 1215.1 and did not require CDI approval.

## MANAGEMENT AND CONTROL

The two abridged organizational charts below, illustrated as of December 31, 2008 and December 31, 2009, show the changes in the Company's holding company system as discussed in the Company History section of this report. The charts are limited to the Company's parent, its ultimate controlling parent, and some affiliated companies, and depict the Company's relationships within the Bank of America Corporation holding company system:

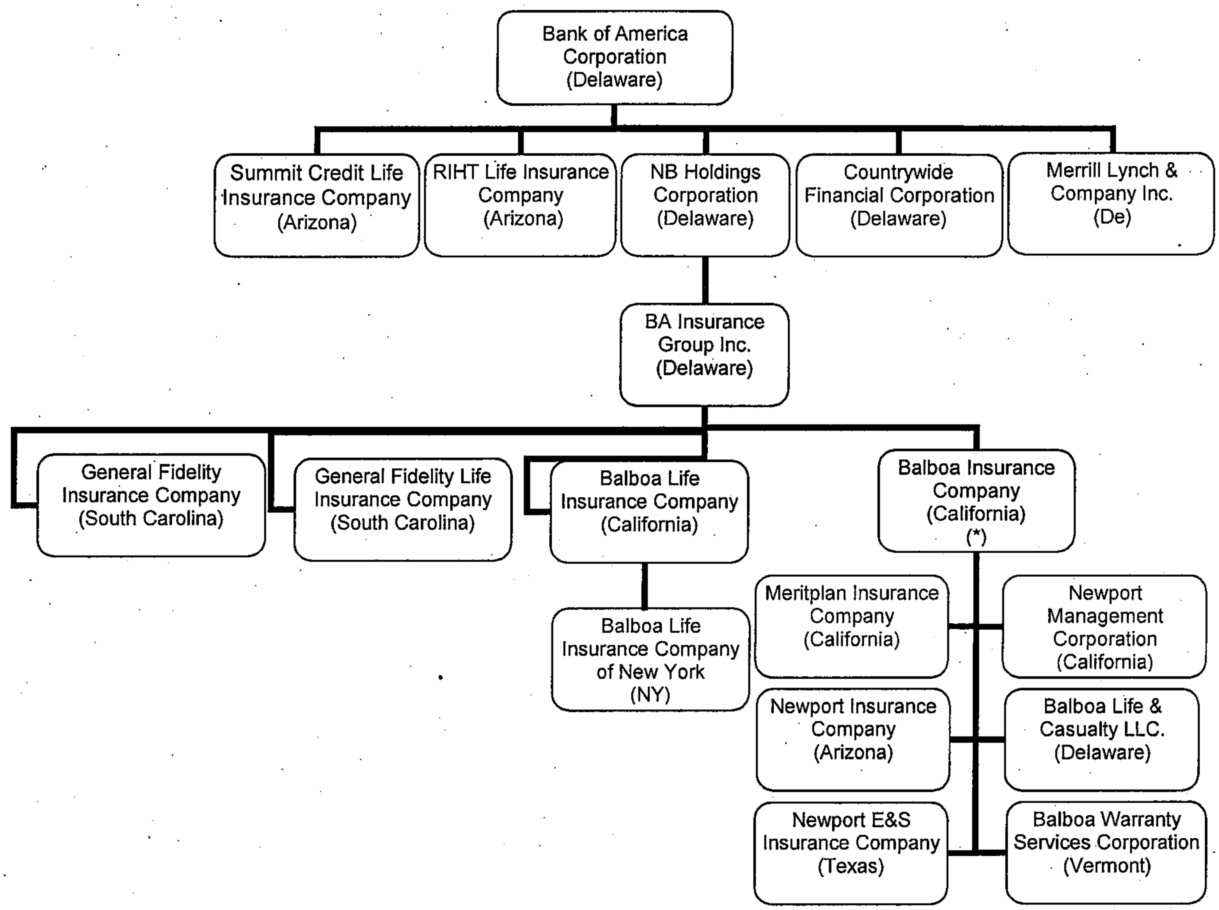
As of December 31, 2008:




(All ownership is 100%, except as otherwise noted)

(*) The Company owns one share of stock out of the 25,000 issued and outstanding shares of Balboa Insurance Company

Subsequent to the examination date, and as of December 31, 2009:




(All ownership is 100%, except as otherwise noted)

(*) The Company owns one share of stock out of the 25,000 issued and outstanding shares of Balboa Insurance Company

Management of the Company, and its affiliates, Balboa Insurance Company, Meritplan Insurance Company, and Newport Insurance Company is vested in a board of directors with no less than seven members elected annually. The Company was not in compliance with its by-laws regarding the minimum number of directors as of December 31, 2008, but has remediated the deficiency as of the date of this Report of Examination. A listing of the members of the board and principal officers serving on December 31, 2008 follows:

## Directors

| Name and Residence | Principal Business Affiliation |
|---|---|
| Franklin T. Dunn (*)<br>Anaheim Hills, California | General Counsel and Secretary<br>BA Insurance Group, Inc. |
| W. Myron Hendry (**)<br>Irvine, California | Chief Operations Officer<br>BA Insurance Group, Inc. |
| Robert V. James (***)<br>Dana Point, California | President<br>BA Insurance Group, Inc. |
| Mark A. McElroy<br>Santa Ana, California | Insurance Executive<br>BA Insurance Group, Inc. |
| Kenneth L. Mertzel<br>Oak Park, California | Finance Executive<br>BA Insurance Group, Inc. |

## Principal Officers

| Name | Title |
|---|---|
| Robert V. James (***) | President |
| Kenneth L. Mertzel | Senior Vice President, Chief Financial Officer |
| Franklin T. Dunn (*) | Secretary, Chief Legal Counsel |
| Laurie A. Fitzgerald | Senior Vice President, Chief Risk Officer |
| Mark A. McElroy | Senior Vice President |
| Harvey Waite | Senior Vice President, Chief Actuary |
| W. Myron Hendry (**) | Senior Vice President, Chief Operations Officer |

(*) Resigned as Board Member effective March 1, 2009
(**) Resigned as Board Member and Executive Officer effective November 27, 2009
(***) Resigned as President, Board Member, and Officer effective January 15, 2010

The Company, and its affiliates, Balboa Insurance Company, Meritplan Insurance Company, and Newport Insurance Company have experienced significant changes in its board of directors and management during and subsequent to the examination period. The resignations have included nine members from the Board and seven executive officers, including the President, Mr. Robert James. As of the date of this Report of Examination, a new President has not been appointed.

Management Agreements

Balboa Insurance Group Intercompany Services Agreement: Effective January 1, 2006, the Company entered into an Intercompany Services Agreement (Intercompany Services Agreement). Parties to the Intercompany Services Agreement were: the Company, Balboa Insurance Company (BIC), Meritplan Insurance Company (MIC), Balboa Life & Casualty LLC (BLC), Newport Management Corporation (NMC), Newport Insurance Company (NIC), Newport E&S Insurance Company (Newport E&S), Balboa Life Insurance Company of New York (BLICNY), Balboa Warranty Services Corporation (BWSC), Insurance Automation Corporation (IAC), Countrywide Insurance Services, Inc. (CIS), Countrywide Insurance Services of Arizona, Inc., Countrywide Insurance Services of Texas, Inc., DirectNet Insurance Agency, Inc. (DirectNet), and DirectNet Insurance Agency of Arizona, Inc., collectively known as the Group Members.

Under the Intercompany Services Agreement, BIC had the option of providing information system services, electronic data processing, accounting and financial functions, underwriting, claims adjusting and payment processing, legal services, actuarial services, and marketing functions to the Group Members, with the Group Members reimbursing BIC for the actual cost of the services provided. In addition, BLC also had the option of providing the Group Members with the aforementioned services, along with payroll services and facilities on an actual cost basis. Under the terms of the Intercompany Services Agreement, the Company compensated BLC for the 2006, 2007, and 2008 years $4.6 million, $4 million, and $4.3 million, respectively. The California Department of Insurance (CDI) approved this agreement on February 27, 2006.

On December 31, 2008, the parties to the Intercompany Services Agreement, terminated the agreement, and the Company entered into a new Intercompany Services Agreement (BAC Intercompany Services Agreement), effective January 1, 2009. This new agreement was entered into because of changes in affiliations made under the Bank of America Corporation (BAC) holding company system that became effective July 1, 2008. Under the BAC Intercompany Services agreement, BIC and BLC continue to provide many of the same intercompany services on an actual cost basis as listed in the prior Intercompany Services Agreement. In addition, under this new agreement, the parties have more flexibility to perform or procure services from any of the participating members. The parties to the BAC Intercompany Services Agreement include: the Company, BIC, MIC, NMC, NIC, BLICNY, BLC, BWSC, CIS, Countrywide Financial Corporation, Countrywide Home Loans, DirectNet, BA Continuum India Private Limited, BA Continuum Costa Rica, BA Continuum Solutions Private Limited, Banc of America Insurance Services, Inc., BA Insurance Services, Inc., Bank of America, N.A., Banc of America Card Servicing Corporation, and BAC. The CDI approved this agreement on April 10, 2009.

Investment Management Agreement: Effective April 17, 2000, the Company, BIC, MIC, NIC, and Insurance Automation Corporation (IAC) entered into an Investment Management Agreement with an affiliate, Countrywide Home Loans, Inc. (CHL). In accordance with the Company's investment guidelines, CHL provided investment management services and was compensated based on actual expenses incurred. The CDI approved this agreement on November 2, 2000. The Company did not pay any fees in 2006, but in 2007 and 2008, the Company paid $40,154 and $5,966, respectively, in investment and miscellaneous fees to CHL under the terms of this agreement.

Effective November 15, 2008, the Investment Management Agreement with CHL was terminated, and the Company, BIC, MIC, and NIC entered into an Investment Management Agreement with another affiliate, Columbia Management Advisors, LLC (CMA). Under the terms of the agreement, CMA provides investment advisory services and manages the investment portfolios of the Company, BIC, BLIC, and NIC. CMA is compensated based on an annual asset-based fee calculated at 0.05 percent of all assets under management. The Company, BIC, MIC, and NIC did not pay any investment or miscellaneous fees to CMA in 2008. The CDI approved this agreement on November 7, 2008. Effective May 1, 2010, the long-term fixed income and equity asset management business of CMA was sold to a non-affiliate, RiverSource Investments, LLC, the asset management arm of Ameriprise Financial, Inc. As a part of that sale, the Investment Management Agreements were assigned to RiverSource Investments, LLC.

Federal Income Tax Filings: The Company is not a party to a Consolidated Federal Income Tax Allocation Agreement, as it elects to file separate federal income tax returns, and paid the following taxes during the examination period:

| Year | Amount |
|---|---|
| 2006 | $ 250,000 |
| 2007 | 0 |
| 2008 | 157,825 |
| Total | $ 407,825 |

## TERRITORY AND PLAN OF OPERATION

As of December 31, 2008, the Company was licensed to transact life and accident and health insurance in all 50 states and in the District of Columbia, Guam, U.S. Virgin Islands, and the Northern Mariana Islands.

The Company specializes in credit related and mass marketed products through financial institutions, including group credit life and accident and health coverage, written in conjunction with consumer loans and revolving charge transactions. In addition, the Company also offers mortgage life insurance on real estate related loans and mass marketed term life and health coverage. In 2008, the Company wrote direct premiums totaling $17.6 million, with the largest percentage written in the following two states:

| State | Direct Premium Written | Percentage of Total |
|---|---|---|
| Texas | $ 2,362,623 | 13.4 % |
| California | 2,315,424 | 13.2% |

Business is primarily marketed and produced through a combination of agencies affiliated with financial institutions and general and independent agents. Banc of America Insurance Services, Inc., an affiliated general agent, is the largest producer. There are approximately 31 general agents and 277 independent agents affiliated with the Company.

## REINSURANCE

### Assumed

As of December 31, 2008, the Company's assumed business is in run-off. The Company reported no material assumed premiums or liabilities as of year-end 2008.

### Ceded

The Company's maximum net retention on any one risk is $200,000. As of December 31, 2008, the Company had the following reinsurance ceded contracts in-force:

| **Type of Treaty and Business** | **Name of Reinsurer** | **Company's Retention** | **Reinsurer's Maximum Limits** |
|---|---|---|---|
| Coinsurance Agreement on Platform Life | Munich American Reassurance Company (Authorized) | 25% July 1, 2004<br>50% January 19, 2005<br>(maximum retention = $200,000) | 37.5% July 1, 2004, (37.5 % with Security Life of Denver Insurance Company in run-off)<br>50% January 19, 2005 of Maximum Amount ranging from $100,000 to $400,000 based on issue age |
| Yearly Renewable Term, Excess of $100,000 on Mortgage Life | Transamerica Occidental Life Insurance Company (Authorized) | $100,000 | $1 Million Automatic Limit |

| Type of Treaty and Business | Name of Reinsurer | Company's Retention | Reinsurer's Maximum Limits |
|---|---|---|---|
| Coinsurance Agreement on Graded Premium Life | Transamerica International Re (Bermuda) Ltd. (Unauthorized) | First dollar 50% quota Share starting at $100,000, up to $100,000 retention | First dollar 50% quota share of amount between $100,000 to $200,000 and excess of retention |
| Abnormal Mortality Stop Loss Reinsurance Agreement | Sirius International Insurance Corporation (Unauthorized) | $8 Million in aggregate | $5 Million in aggregate |
| Catastrophe Excess of Loss Reinsurance Agreement on Group and Individual Life and Accidental Death and Dismemberment | Munich Reinsurance America, Inc. (Authorized) | $1 Million any one loss occurrence | 1st layer: $4 Million / loss occurrence (1)<br>2nd layer: $5 Million / loss occurrence (2) |

(1) Not to exceed $8 million in the aggregate during the term of the contract.
(2) Not to exceed $10 million in the aggregate during the term of the contract.

As of December 31, 2008, reserve credits taken for all ceded reinsurance totaled $7.8 million or 25.6% of capital and surplus. Approximately 80% of the reserve credits taken related to the agreements that are currently in run-off with American Health and Life Insurance Company.

## ACCOUNTS AND RECORDS

During 2008, the Company performed a review of its rating practices for compliance with statutory requirements and it was determined that the Company and its wholly-owned subsidiary, Balboa Life Insurance Company of New York, had charged rates at variance from the permitted rates on certain policies. Therefore, in accordance with the Statement of Statutory Accounting Principles No. 3 – Accounting Changes and Corrections of Errors, the premium refunds plus interest due to policyholders, net of return commission and premium tax, were reported as a correction of an error through an adjustment to surplus in the 2008 year. The adjustment, net of tax, decreased surplus approximately by $1.9 million. It is recommended that the Company implement stronger controls that ensure only the permitted rates are charged on policies.

## FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2008

Summary of Operations and Capital and Surplus Account
for the Year Ended December 31, 2008

Reconciliation of Capital and Surplus
from December 31, 2005 through December 31, 2008

## Statement of Financial Condition
## as of December 31, 2008

| Assets | Ledger and Nonledger Assets | Assets Not Admitted | Net Admitted | Notes |
|---|---|---|---|---|
| Bonds | $ 16,603,876 | $ | $ 16,603,876 | |
| Common stocks | 17,368,785 | | 17,368,785 | |
| Cash and short-term investments | 5,405,260 | | 5,405,260 | |
| Receivable for securities | 708,308 | | 708,308 | |
| Investment income due and accrued | 108,763 | | 108,763 | |
| Premiums and agent's balances in course of collection | 312,106 | | 312,106 | |
| Deferred premiums, agents' balances and installments booked but deferred and not yet due | 437,024 | | 437,024 | |
| Current federal and foreign income tax recoverable and interest thereon | 1,278,761 | | 1,278,761 | |
| Net deferred tax asset | 27,658 | | 27,658 | |
| Guaranty funds receivable or on deposit | 136,193 | | 136,193 | |
| Receivable from parent, subsidiaries and affiliates | 685,142 | | 685,142 | |
| Aggregate write-ins for other than invested assets | 183,116 | | 183,116 | |
| Total assets | $ 43,254,992 | $ 0 | $ 43,254,992 | |

| Liabilities, Capital and Surplus | | | |
|---|---|---|---|
| Aggregate reserve for life contracts | | $ 6,514,595 | (1) |
| Aggregate reserve for accident and health contracts | | 1,766,695 | (1) |
| Contract claims: | | | |
| Life | | 547,367 | (1) |
| Accident and health | | 1,387,535 | (1) |
| Interest maintenance reserve | | 1,493,205 | |
| General expenses due or accrued | | 95,661 | |
| Taxes, licenses and fees due or accrued | | 29,747 | |
| Asset valuation reserve | | 51,237 | |
| Reinsurance in unauthorized companies | | 3,377 | |
| Payable to parent, subsidiaries and affiliates | | 471,890 | |
| Aggregate write-ins for liabilities | | 201,416 | |
| Total liabilities | | 12,562,725 | |
| Common capital stock | $ 2,500,000 | | |
| Gross paid-in and contributed surplus | 10,420,150 | | |
| Aggregate write-ins for special surplus funds | 2,211,250 | | |
| Unassigned surplus | 15,560,867 | | |
| Capital and surplus | | 30,692,267 | |
| Total liabilities, capital and surplus | | $ 43,254,992 | |

Summary of Operations and Capital and Surplus Account
for the Year Ended December 31, 2008

Statement of Income

| | | |
|---|---|---|
| Premiums and annuity considerations | $ 16,155,992 | |
| Net investment income | 902,269 | |
| Amortization of interest maintenance reserve | 121,965 | |
| Commission and expense allowances on reinsurance ceded | 352,892 | |
| Aggregate write-ins for miscellaneous losses | (394) | |
| Total | | $ 17,532,724 |
| Death benefits | $ 1,718,508 | |
| Annuity benefits | 346,256 | |
| Disability benefits and benefits under accident and health policies | 3,232,275 | |
| Decrease in aggregate reserves for life and accident and health | (1,102,479) | |
| Commissions on premiums, annuity considerations and deposit type | 2,718,853 | |
| Commissions and expense allowances on reinsurance assumed | 429 | |
| General insurance expenses | 6,341,585 | |
| Insurance taxes, licenses and fees, excluding federal income taxes | 882,716 | |
| Decrease in loading on deferred and uncollected premiums | (39,307) | |
| Aggregate write-ins for deductions | 5,535 | |
| Total | | 14,104,371 |
| Net gain from operations before federal income taxes | | 3,428,353 |
| Federal and foreign income taxes incurred | | (529,152) |
| Net income | | $ 3,957,505 |

Capital and Surplus Account

| | | |
|---|---|---|
| Capital and surplus, December 31, 2007 | | $ 27,887,552 |
| Net income | $ 3,957,505 | |
| Change in net unrealized capital gains | 707,023 | |
| Change in net deferred income tax | 20,754 | |
| Change in nonadmitted assets and related items | 207,926 | |
| Change in liability for reinsurance in unauthorized companies | 451 | |
| Change in assets valuation reserve | (7,572) | |
| Surplus adjustment: Change in surplus as a result of reinsurance | (155,466) | |
| Aggregate write-ins for losses in surplus | (1,925,906) | |
| Net change in capital and surplus for the year | | 2,804,715 |
| Capital and surplus, December 31, 2008 | | $ 30,692,267 |

Reconciliation of Capital and Surplus
from December 31, 2005 through December 31, 2008

| | Gain in Surplus | Loss in Surplus | |
|---|---|---|---|
| Capital and surplus, December 31, 2005 per Examination | | | $ 47,165,776 |
| Net income | $ 13,679,139 | $ | |
| Change in net unrealized capital gains | 1,834,379 | | |
| Change in net deferred income tax | | 618,061 | |
| Change in nonadmitted assets and related items | 1,101,028 | | |
| Change in liability for reinsurance in unauthorized companies | | 3,377 | |
| Change in asset valuation reserve | 59,112 | | |
| Surplus adjustments: Paid-in | | 15,000,000 | |
| Change in surplus as a result of reinsurance | | 599,823 | |
| Dividends to stockholders | | 15,000,000 | |
| Aggregate write-ins for losses in surplus | | 1,925,906 | |
| Totals | $ 16,673,658 | $ 33,147,167 | |
| Net decrease in capital and surplus | | | (16,473,509) |
| Capital and surplus, December 31, 2008, per Examination | | | $ 30,692,267 |

## COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Aggregate Reserve for Life Contracts
Aggregate Reserve for Accident and Health Contracts
Contract Claims - Life
Contract Claims - Accident and Health

A Life Actuary from the California Department of Insurance performed an actuarial evaluation of the Company's above captioned reserves as of December 31, 2008. Based on the work performed, the Company's December 31, 2008 reserves have been accepted for purposes of this examination.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Accounts and Records (Page 11): It is recommended that the Company implement stronger controls that ensure only the permitted rates are charged on policies.

### Previous Report of Examination

Accounts and Records (Page 9): It was recommended that the Company and Balboa Insurance Company change their procedures so that premium receipts not associated with the Pooling Agreement are remitted directly to the company that issued the policy. The Company complied with this recommendation.

## ACKNOWLEDGEMENT

The courtesy and cooperation extended by the Company's officers and employees during the course of this examination are hereby acknowledged.

Respectfully submitted,

/S/

Edward W. Aros, CFE
Examiner-In-Charge
Senior Insurance Examiner, Supervisor
Department of Insurance
State of California