REPORT OF EXAMINATION
OF THE

GOLDEN STATE MUTUAL LIFE
INSURANCE COMPANY

AS OF
DECEMBER 31, 2003

Participating State
and Zone:

California

Filed February 8, 2005

TABLE OF CONTENTS

Los Angeles, California
October 8, 2004

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

Honorable John Morrison
Secretary, Zone IV-Western
Commissioner of Insurance and Securities
Montana Department of Insurance
Helena, Montana

Honorable John Garamendi
Insurance Commissioner
California Department of Insurance
Sacramento, California

Dear Chairman and Commissioners:

Pursuant to your instructions, an examination was made of the

GOLDEN STATE MUTUAL LIFE INSURANCE COMPANY

(hereinafter also referred to as the Company) at its home office located at 1999 West Adams Boulevard, Los Angeles, California 90018.

SCOPE OF EXAMINATION

The previous examination of the Company was made as of December 31, 2000. This examination covers the period from January 1, 2001 through December 31, 2003. The examination included a review of the Company's practices and procedures, an examination of management records, tests and analyses of detailed transactions, and an evaluation of assets and a determination of liabilities as of December 31, 2003, as deemed necessary under the circumstances.

This examination was conducted by the California Department of Insurance pursuant to the National Association of Insurance Commissioners' plan of examination. 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: company history; corporate records; fidelity bonds and other insurance; officers', employees' and agents' welfare and pension plans; growth of company; mortality; and sales and advertising.

SUMMARY OF SIGNIFICANT FINDINGS

As a result of this examination, capital and surplus as of December 31, 2003, has been reduced by $598,000 to $7.2 million. The examination adjustments were made in multiple accounts and, in many instances, reflected the Company's inability to properly support account balances.

As noted under the Accounts and Records section of this report, the Company was unable to provide much of the supporting documentation for information reported in its financial statements. This included routine examination requests such as account reconciliations, detailed supporting records, schedules and reports. Some of the delays and inability to provide documentation were due to the temporary loss of key employees for which the Company had no knowledgeable replacements. As a result of the inability to obtain some of the required documentation, a significant amount of the examination work was made possible with the assistance of the Company's independent public accounting firm.

During the course of the examination, the Company retained a consultant to assist with the duties and functions of the vacated Controllers position. In addition, the Treasurer also assumed many of the duties of the Controller.

As a result of the above, it is strongly recommended that the Company continue to staff its accounting department and other key areas of its operations with qualified and knowledgeable personnel. The Company should also prepare and maintain adequate documentation to support all amounts reported in its financial statements.

MANAGEMENT AND CONTROL

Management of the Company is vested in a nine-member board of directors. A listing of the members of the board of directors and the principal officers serving on December 31, 2003 follows:

Directors

Name and Residence	Principal Business Affiliation
Verdun J. Arnaud Los Angeles, California	Senior Vice President and Actuary Golden State Mutual Life Insurance Company
Herbert Carter Los Angeles, California	President Emeritus California State University Dominguez Hills
John S. Chase Houston, Texas	President John S. Chase Architects, Inc.
Lonear W. Heard-Davis Cerritos, California	President Heard Management Company
Ronald R. Dobbins Laverock, Pennsylvania	Consultant United American Healthcare Corporation
Roland C. Baker Chicago, Illinois	Retired
Ivan J. Houston Los Angeles, California	Retired
Norman B. Houston Los Angeles, California	Business Consultant
Larkin Teasley Los Angeles, California	President and Chief Executive Officer Golden State Mutual Life Insurance Company

Principal Officers

Name	Title
Larkin Teasley	President and Chief Executive Officer
Verdun J. Arnaud	Senior Vice President and Actuary
Artemease L. Wimsatt	Secretary
Erlinda P. Mangarin	Treasurer
Charles L. James	Vice President and General Agency Director
Dwayne P. Mitchell	Vice President and Agency Director
Gloria Nathan*	Controller

*resigned in February 2004

TERRITORY AND PLAN OF OPERATION

The Company operates as a mutual insurance company and is authorized to transact life and disability insurance in the following thirteen states and the District of Columbia as of December 31, 2003:

California	Maryland	Tennessee
Georgia	Michigan	Texas
Hawaii	Mississippi	Virginia
Illinois	Nevada	
Louisiana	North Carolina	

During 2003, the Company wrote direct premiums of $11.1 million of which, 93% represented life and the remaining 7% consisted of accident and health business. The states in which the Company wrote the majority of its direct premiums were California (50%), Texas (19%), North Carolina (10.6%), Illinois (10.4%), and Michigan (7%).

The Company markets its business primarily through 85 exclusively licensed account executives, which are supervised by associate sales managers who, in turn, are managed by district managers. The Company also assumes small portions of group life insurance contracts underwritten on employees of large corporations.

REINSURANCE

Assumed

The Company has assumed various percentages (ranging from 2% to 25%) of group life insurance policies that were issued by large admitted life insurance companies on employees of large national corporations. The underlying policies are primarily monthly or yearly renewable term life with some other forms of group life. The assumed contracts are administrated on an annual basis and there is usually a year lag in the reporting, in some cases a two year lag. It is the Company's practice to set the premium receivable equal to the premium received in the prior year. The Company then sets the group life incurred but not reported (IBNR) reserves equal to the premium receivable. As a result, the Company reports no gain or loss on the assumed business.

Effective January 1, 2002, Company's participation in its assumed group life insurance business with Disney Worldwide Services, Inc. was reduced from 5% to 2%. This change in participation, along with the Company's practice of booking assumed premium based on prior year receipts and IBNR in a like amount, resulted in an overstatement of $8.4 million on the assumed premiums and group life IBNR reserves. As a result of the reporting lags and the practice of estimating amounts due and payable by each party under the terms of assumed reinsurance agreements, the Company's reinsurance schedules and exhibits in its financial statements could not be relied upon. A review of the financial statements of the principle insurers that cede business to the Company disclosed that the amounts reported by the ceding companies were materially the same as what the Company reported as assumed. Based on these comparisons of financial statements the Company's surplus as of year-end 2003 was not materially misstated as a result of reinsurance. It is recommended that the Company discontinue the practice of booking assumed premium based on prior year's collected premium. The Company should make every attempt to book premium that is actually due them for the current calendar year.

Ceded

Ordinary life: The Company has a continuing yearly renewable term agreement with an authorized insurer, which provides a maximum policy retention of $25,000 on ordinary life, waiver of premium and disability. Reinsurance on ordinary life is automatic up to $175,000, and on waiver of premium, up to the amount corresponding to life insurance reinsured. Reinsurance on accidental death is automatic up to $250,000.

Group life, accidental death and dismemberment: The Company has a continuing agreement with an authorized reinsurer covering the excess over a retention of $25,000 on group life and 100% of accidental death and dismemberment up to a maximum of $200,000 per person.

Long term disability: The Company has two long-term disability agreements with an authorized reinsurer. One agreement is on an 80/20 coinsurance basis, and the other is on a 90/10 coinsurance basis.

ACCOUNTS AND RECORDS

The examination experienced delays in obtaining supporting documentation for information reported by the Company in its financial statements. This included routine examination requests such as account reconciliations, detailed supporting records, schedules and reports. In some instances, the Company was unable to provide the documentation. Some of the delays and inability to provide documentation were due to the temporary loss of key employees for which the Company had no knowledgeable replacements. As a result, a significant amount of the examination work was facilitated with the assistance of the Company's independent public accounting firm.

California Insurance Code (CIC) Section 734 states that every company or person from whom information is sought, and its officers, directors, employees, and agents, shall provide to the examiners appointed pursuant to this article, timely, convenient, and free access at all reasonable hours at its offices to all books, records, accounts, papers, documents, and any or all computer or other recordings relating to the property, assets, business, and affairs of the company being examined. The Company's inability to provide certain supporting documentation that was requested is in violation of CIC Section 734.

It is recommended that the Company comply with CIC Section 734 in all future examinations and that adequate financial statement documentation be maintained to support all reported information. The documentation should be prepared in sufficient detail as to allow for a full and complete audit trail from the Company's financial statements to individual records.

Information Systems

A review of the Company's general controls over its information systems disclosed that weaknesses exist in areas such as information security, segregation of duties, operational controls desktop standards, and business continuity planning. It is recommended that Company evaluate and make appropriate changes to strengthen its information system controls.

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Statement of Financial Condition as of December 31, 2003

Summary of Operations and Capital and Surplus Account
for the Year Ended December 31, 2003

Reconciliation of Capital and Surplus from December 31, 2000
through December 31, 2003

Reconciliation of Examination Changes as of December 31, 2003

Statement of Financial Condition
as of December 31, 2003

Assets	Ledger and Nonledger Assets	Assets Not Admitted	Net Admitted Assets	Notes
Bonds	$ 51,817,360	$ 70,857	$ 51,746,503	(1)
Stocks: Preferred	322,181		322,181	
Common	843,609		843,609	
Mortgage loans on real estate: First liens	30,551,248		30,551,248	
Real estate:				
Properties occupied by the company	1,049,670		1,049,670	(2)
Investment in real estate	17,112		17,112	
Contract loans	4,877,023	(24,645)	4,901,668	(3)
Cash and short-term investments	5,868,786	197,011	5,671,775	(4)
Reinsurance ceded: Amounts recoverable from reinsurers	195,549		195,549	
Electronic data processing equipment and software	66,730		66,730	
Guaranty funds receivable or on deposits	1,570		1,570	
Uncollected premiums and agents' balances in course of collection	6,503,104	736,932	5,766,172	(5)
Investment income due and accrued	1,250,169	336,204	913,965	(6)
Furniture and equipment	39,035	39,035	0	
Aggregate write-ins for other than invested assets	582,627	582,627	0	
Total assets	$ 103,985,773	$ 1,938,021	$ 102,047,752	

Liabilities, Surplus and Other Funds				
Aggregate reserve for life contracts			$ 78,175,385	(7)
Aggregate reserve for accident and health contracts			293,955	(7)
Liability for deposit-type contracts			475,769	(7)
Contract claims:				
Life			12,740,733	(7)
Accident and health			123,042	(7)
Premiums and annuity considerations for life and accident and health contracts received in advance			299,867	
Contract liabilities not included elsewhere:				
Interest maintenance reserve			570,261	(8)
Commissions to agents due and accrued			17,203	
General expenses due or accrued			81,465	
Taxes, licenses and fees due or accrued			53,954	
Unearned investment income			160,106	
Amounts withheld or retained by company as agent or trustee			7,979	
Amounts held for agents' account			142,793	(9)
Remittances and items not allocated			12,966	(10)
Liability for benefits for employees and agents			783,592	
Miscellaneous liabilities: Asset valuation reserve			760,997	(11)
Aggregate write-ins for liabilities			106,373	(12)
Total liabilities			94,806,440	
Gross paid-in and contributed surplus		$ 2,142,649		
Unassigned surplus		5,098,663		
Capital and surplus			7,241,312	
Total liabilities, capital and surplus			$ 102,047,752	

Summary of Operations and Capital and Surplus Account
for the Year Ended December 31, 2003

Statement of Income

Premiums and annuity considerations for life and accident and health contracts		$ 17,015,574
Net investment income		6,472,919
Amortization of interest maintenance reserve (IMR)		(393,056)
Miscellaneous income: Aggregate write-ins for miscellaneous income		54,669
Total		23,150,106
Death benefits		7,505,760
Matured endowments (excluding guaranteed annual pure endowments)		173,845
Annuity benefits		488,592
Disability benefits and benefits under accident and health contracts		555,314
Surrender benefits and withdrawals for life contracts		2,741,719
Group conversions		8,249
Interest and adjustment on contract or deposit-type funds		86,760
Increase in aggregate reserves for life and accident and health contracts		810,498
Commissions on premiums, annuity considerations, and deposit-type contracts		2,081,587
General insurance expenses		7,844,130
Insurance taxes, licenses and fees, excluding federal income taxes		738,127
Increase in loading on deferred and uncollected premiums		(35,300)
Aggregate write-ins for deductions		840,145
Total		23,839,426
Net loss from operations before dividends to policyholders and federal income taxes		(689,320)
Dividends to policyholders		41,258
Federal income taxes incurred		2,562
Net loss		$ (733,140)

Capital and Surplus Account

Capital and surplus, December 31, 2002		$ 7,956,464
Net loss	$ (733,140)	
Change in net unrealized capital gains	457,132	
Change in nonadmitted assets and related items	(44,785)	
Change in asset valuation reserve	(198,323)	
Aggregate write-ins for losses in surplus	(196,036)	
Net change in capital and surplus for the year		(715,152)
Capital and surplus, December 31, 2003		$ 7,241,312

<u>Reconciliation of Capital and Surplus</u>
<u>from December 31, 2000 through December 31, 2003</u>

Capital and surplus, December 31, 2000, per Examination			$ 7,709,789
	Gain in Surplus	Loss in Surplus	
Net income	$ 182,219	$	
Net unrealized capital gains	154,486		
Change in nonadmitted assets and related items		317,002	
Change in asset valuation reserve		229,268	
Aggregate write-ins for losses in surplus		258,912	
Total gains and losses in surplus	$ 336,705	$ 805,782	
Decrease in capital and surplus			(468,477)
Capital and surplus, December 31, 2003 per Examination			$ 7,241,312

Reconciliation of Examination Changes
as of December 31, 2003

Assets	Per Company	Per Examination	Surplus Increase (Decrease)	Notes
Bonds	$ 51,817,360	$ 51,746,503	$ (70,857)	(1)
Contract loans	4,877,023	4,901,668	24,645	(3)
Cash and short-term investments	5,868,786	5,671,775	(197,011)	(4)
Uncollected premiums and agents' balance in course of collection	14,160,340	5,766,172	8,394,168	(5)
Investment income due and accrued	1,250,169	913,965	(336,204)	(6)
Liabilities				
Aggregate reserve for life contracts	87,027,553	78,175,385	8,852,168	(7)
Aggregate reserve for accident and health contracts	286,455	293,955	(7,500)	(7)
Contract claims: Life	12,705,717	12,740,733	(35,016)	(7)
Contract liabilities not included elsewhere:				
Interest Maintenance reserve	131,575	570,261	(438,686)	(8)
Amounts held for agents' account	152,685	142,793	9,892	(9)
Remittances and items not allocated	(234,300)	12,966	(247,266)	(10)
Miscellaneous Liabilities: Asset valuation reserve	682,876	760,997	(78,121)	(11)
Aggregate write-ins for liabilities	426,749	106,373	320,376	(12)
Net decrease to capital and surplus			$ (597,748)	
Capital and Surplus, December 31, 2003 per Company			7,839,060	
Capital and Surplus, December 31, 2003 per Examination			$ 7,241,312	

COMMENTS ON FINANCIAL STATEMENT ITEMS

(1) Bonds

The above captioned account has been decreased by $70,857 as a result of the Company including one security in its Annual Statement, Schedule D that was sold in 2003.

(2) Real Estate: Properties Occupied by the Company

In October 2004, the Company sold it district office building property for $1.7 million. It is anticipated that the escrow will close on this sale in mid-November shortly after the Company vacates the building. Under the terms of the sale, the Company has the option to lease-back the building on a month-to-month basis for a period of up to four months. An independent appraisal of the property obtained by the Company just prior to the sale indicated a market value of $1.3 million. The Company and its public accounting firm indicated that the Company has net operating loss (NOL) carryforwards ($922,697) that can be applied toward the gain on the sale ($1.4 million), which will be in excess of the NOL. As the NOL will be realized within one year, the Company anticipates including a deferred tax asset of approximately $314,000 in its September 30, 2004 financial statements in accordance with Statements of Statutory Accounting Principles (SSAP) No. 10.

(3) Contract Loans

The Company understated its policy (contract) loans by $24,645, which consists of the difference between the general ledger and the detail listing of policy loans and an adjustment for policy loans that exceed the cash surrender value.

(4) Cash and Short-Term Investments

The captioned asset has been reduced by $197,011 and represents differences noted by the Company's certified public accountants ($46,781) and an adjustment ($150,230) for amounts included by the Company in its cash account for which there was no supporting documentation.

(5) Uncollected Premiums and Agents' Balances in Course of Collection

The Company overstated its uncollected premiums on assumed in-force business by $8.4 million. This overstatement was the result of the Company booking its assumed premium based on the prior years collected premiums, which was based on a higher participation percentage than the current year. Additionally, there were delays by ceding companies in reporting on 2002 assumed business. In conjunction with this asset overstatement, the Company also overstated its aggregate reserves for life contracts in the same amount (see Note 8). For purposes of this examination report and to properly reflect the overstatement of assets, liabilities, premium income and incurred expenses, reclassifications were made to the financial statements included in this report. The changes, although material, were all offsetting and had no effect on the Company's surplus.

(6) Investment Income Due and Accrued

Investment income due and accrued was overstated by the Company in the amount of $336,204.

(7) Aggregate Reserve for Life Contracts
(7) Aggregate Reserve for Accident and Health Contracts
(7) Liability for Deposit-Type Contracts
(7) Contract Claims: Life and Accident and Health

A life actuary from the California Department of Insurance (CDI) reviewed the report of the consulting actuary (Consultant) that was retained by the accounting firm performing the statutory audit of the Company (CPA). The Consultant provided an actuarial review of the above captioned liability accounts and other related asset accounts. Although the Consultant concluded that in all material respects the items examined were properly stated in the Company's year-end 2003 Annual Statement, the following is a summary of the examination adjustments that were made based on the Consultant's review and additional information received from the CPAs:

Liability Account	December 31, 2003		
	Per Company	Per Examination	Examination Change
Aggregate Reserve for Life Contracts	$78,633,385	$78,175,385	$(458,000)
Aggregate Reserve for A&H Contracts	286,455	293,955	7,500
Contract Claims: Life	12,705,717	12,740,733	35,016

Aggregate Reserve for Life Contracts: The reduction in this account in the amount of $458,000 was based partially on a review of a sample of inforce policies by the Company's CPAs. It was noted that the Company's inforce policy listing included policies that had already paid out or surrendered, which resulted in an estimated overstatement of the reserves by approximately $643,000. A corresponding adjustment (reduction) was made to the uncollected premium asset account in the amount of $105,000 and was netted against the reserve overstatement for purposes of this examination report (net $538,000 reduction). In addition, the Consultant recommended increases in this liability due to the Company's use of an inappropriate factor on the premium notice ordinary line along with inconsistencies in reinsurance reserve credits taken in the Annual Statement. The total of these two adjustments by the Consultant was to increase the reserves by $80,000. In total, the CPA's and the Consultant's adjustments decreased the Company's aggregate reserves for life contracts by $458,000.

It was also noted during this examination that the Company booked group life incurred but not reported reserves equal to the uncollected assumed premium receivable of $8.4 million as previously discussed in Note (6). As a result, the above aggregate reserve for life contracts and the uncollected assumed premium asset account have each been reduced by $8.4 million. For purposes of this examination report and to properly reflect the overstatement of assets, liabilities, premium income and incurred expenses, changes were made to the Company's reported amounts in the financial statements included in this report. The changes, although material, were all offsetting and had no effect on the Company's surplus.

Aggregate Reserve for Accident and Health Contracts: Reimbursements from the reinsurers were reviewed by the Consultant to verify reinsurance recoverables. The review indicated that the reserves were estimated to be understated by an amount between $5,000 and $10,000. For examination purposes, the mid point of $7,500 was used.

Contract Claims: Life: Based on a review of pending claims and individual incurred but not reported liabilities by the Company's CPAs, the reserves for life contract claims were understated by $35,016.

In addition to the above, the Consultant noted and recommended that the Company do the following:

- The Company does not hold an immediate payment of claims reserve as required by Actuarial Guideline (Guidelines) XXXII. It was determined that this requirement is offset by higher than minimum reserves held on issues from 1985 through 1994. This offset is allowed in Section IV of the Guidelines. The Company should be prepared to demonstrate this offset in the future;

- Document its reserving procedures and, to the extent practicable, mechanize these procedures which are currently manual;

- Use a more accurate method to calculate its accidental death benefit (ADB) reserves;

- Be prepared to demonstrate that an immediate payment of claims reserve is not required;
- Report its disabled lives reserves gross and net of reinsurance; and
- Accrue net deferred rather than gross deferred premiums on its industrial business.

In addition, it is recommended that the Company make sure that no policies are reserved by a method that produces a lower reserve than that called for in the corresponding policy form.

The Consultant further noted that in the future, the Company's asset adequacy analysis in support of its actuarial opinion should more thoroughly justify and test the effect of expense levels.

(8) Contract Liabilities Not Included Elsewhere: Interest Maintenance Reserve

The Company offsets its realized losses on impaired securities against its realized gain on sales of other securities, which is not in compliance with the Statements of Statutory Accounting Principles (SSAP) No. 7. Under SSAP No. 7, losses relating to impairment, and all realized and unrealized gains and losses on common stocks are classified as credit-related and should be considered as a permanent write-down. As a result, the captioned account was understated by $438,686.

(9) Amounts Held for Agents' Account

Based on a review of the detail listing of general agents' accounts, it was noted that the total of the listing did not reconcile to the Annual Statement and was overstated by $9,892.

(10) Remittances and Items Not Allocated

Based on the Company's inability to provide sufficient support to document debit balances included in the caption account, an examination adjustment increasing the liability was made in the amount of $247,266.

(11) Miscellaneous Liabilities: Asset Valuation Reserve

The captioned account has been increased by $78,121 primarily the result of the Company incorrectly booking its realized capital gains and losses on certain assets that are subject to the asset valuation reserve.

(12) Aggregate Write-ins for Liabilities

This account consists of unclaimed funds, group contingency liability, and accrued interest on certificates of contribution. The Company overstated the balance on this account by $320,376. The adjustment was made due to differences in unclaimed fund balances between the general ledger and detail listings filed with the State of California. In addition, it was determined that a group contingency liability contract reserve was no longer required.

SUMMARY OF COMMENTS AND RECOMMENDATIONS

Current Report of Examination

Summary of Significant Finding (Page 2): It is strongly recommended that the Company continue to staff its accounting department and other key areas of its operations with qualified and knowledgeable individuals.

Reinsurance – Assumed (Page 5): It is recommended that the Company discontinue the practice of booking assumed premium based on prior year's collected premium. The Company should make every attempt to book premium that is actually due them for the current calendar year.

Accounts and Records (Page 6): It is recommended that the Company comply with California Insurance Code Section 734 in all future examinations and that adequate financial statement documentation be maintained to support all reported information.

Accounts and Records - Information Systems (Page 7): It is recommended that Company evaluate and make appropriate changes to strengthen its information system controls.

Aggregate Reserve for Life Contracts; Aggregate Reserve for Accident and Health Contracts; Liability for Deposit–Type Contracts; and Contract Claims: Life and Accident Health (Page 13): It is recommended that the Company do the following:

1. Document its reserving procedures and, to the extent practicable, mechanize these procedures which are currently manual;
2. Use a more accurate method to calculate its accidental death benefit (ADB) reserves;
3. Be prepared to demonstrate that an immediate payment of claims reserve is not required;
4. Report its disabled lives reserves gross and net of reinsurance;
5. Accrue net deferred rather than gross deferred premiums on its industrial business;
6. Ensure that no policies are reserved by a method that produces a lower reserve than that called for in the corresponding policy form; and

7. Improve its asset adequacy modeling techniques and utilize more refined underlying assumptions

Previous Report of Examination

Subsequent Event (Page 2): In May 2001, the Company filed a preliminary review application with the California Department of Insurance seeking demutualization by converting into a stock company. This application was denied.

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/

Charles DePalma, CFE
Supervising Insurance Examiner
Department of Insurance
State of California