

SERFF Tracking Number: FIVE-126307396 State: Arkansas  
 Filing Company: 5 Star Life Insurance Company State Tracking Number: 43518  
 Company Tracking Number: 2007  
 TOI: L08 Life - Other Sub-TOI: L08.000 Life - Other  
 Product Name: Report of Examination  
 Project Name/Number: /

## Filing at a Glance

Company: 5 Star Life Insurance Company  
 Product Name: Report of Examination  
 TOI: L08 Life - Other

Sub-TOI: L08.000 Life - Other  
 Filing Type: Form

Implementation Date Requested:  
 State Filing Description:

SERFF Tr Num: FIVE-126307396 State: Arkansas  
 SERFF Status: Closed-Filed- State Tr Num: 43518  
 Closed  
 Co Tr Num: 2007 State Status: Filed-Closed  
 Reviewer(s): Linda Bird  
 Author: Mildred Hunt Disposition Date: 09/17/2009  
 Date Submitted: 09/16/2009 Disposition Status: Filed-Closed  
 Implementation Date:

## General Information

Project Name:  
 Project Number:  
 Requested Filing Mode:  
 Explanation for Combination/Other:  
 Submission Type: New Submission  
 Overall Rate Impact:  
 Filing Status Changed: 09/17/2009

Deemer Date:  
 Submitted By: Mildred Hunt  
 Filing Description:  
 2007 Report of Examination

Status of Filing in Domicile:  
 Date Approved in Domicile:  
 Domicile Status Comments:  
 Market Type:  
 Group Market Size:  
 Group Market Type:  
 Explanation for Other Group Market Type:  
 State Status Changed: 09/17/2009  
 Created By: Mildred Hunt  
 Corresponding Filing Tracking Number:

## Company and Contact

### Filing Contact Information

Mildred Hunt, Compliance Manager  
 909 North Washington Street  
 Alexandria, VA 22314

mhunt@afba.com  
 703-706-5975 [Phone]  
 703-224-0214 [FAX]

### Filing Company Information

5 Star Life Insurance Company

CoCode: 77879

State of Domicile: Louisiana

<i>SERFF Tracking Number:</i>	<i>FIVE-126307396</i>	<i>State:</i>	<i>Arkansas</i>
<i>Filing Company:</i>	<i>5 Star Life Insurance Company</i>	<i>State Tracking Number:</i>	<i>43518</i>
<i>Company Tracking Number:</i>	<i>2007</i>		
<i>TOI:</i>	<i>L08 Life - Other</i>	<i>Sub-TOI:</i>	<i>L08.000 Life - Other</i>
<i>Product Name:</i>	<i>Report of Examination</i>		
<i>Project Name/Number:</i>	<i>/</i>		
<b>909 North Washington Street</b>	<b>Group Code: 77879</b>	<b>Company Type: Life linsurance</b>	
<b>Alexandria, VA 22314</b>	<b>Group Name: NAIC</b>	<b>Company</b>	
<b>(703) 706-5975 ext. [Phone]</b>	<b>FEIN Number: 54-1829709</b>	<b>State ID Number:</b>	

-----  
**Filing Fees**

Fee Required?	Yes
Fee Amount:	\$20.00
Retaliatory?	No
Fee Explanation:	Per form
Per Company:	No

COMPANY	AMOUNT	DATE PROCESSED	TRANSACTION #
5 Star Life Insurance Company	\$20.00	09/16/2009	30592639

SERFF Tracking Number: FIVE-126307396

State: Arkansas

Filing Company: 5 Star Life Insurance Company

State Tracking Number: 43518

Company Tracking Number: 2007

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## Correspondence Summary

### Dispositions

Status	Created By	Created On	Date Submitted
Filed-Closed	Linda Bird	09/17/2009	09/17/2009

SERFF Tracking Number: FIVE-126307396 State: Arkansas  
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## Disposition

Disposition Date: 09/17/2009

Implementation Date:

Status: Filed-Closed

Comment:

Rate data does NOT apply to filing.

SERFF Tracking Number: FIVE-126307396 State: Arkansas  
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Schedule	Schedule Item	Schedule Item Status	Public Access
Supporting Document	Flesch Certification		No
Supporting Document	Application		No
Supporting Document	Cover Letter		Yes
Supporting Document	Report of Examination		No
Supporting Document	Response to Report of Examination		No

SERFF Tracking Number: FIVE-126307396

State: Arkansas

Filing Company: 5 Star Life Insurance Company

State Tracking Number: 43518

Company Tracking Number: 2007

TOI: L08 Life - Other

Sub-TOI: L08.000 Life - Other

Product Name: Report of Examination

Project Name/Number: /

## Supporting Document Schedules

**Item Status:**  
**Status Date:**

**Bypassed - Item:** Flesch Certification  
**Bypass Reason:** Not applicable  
**Comments:**

**Item Status:**  
**Status Date:**

**Bypassed - Item:** Application  
**Bypass Reason:** Not applicable  
**Comments:**

**Item Status:**  
**Status Date:**

**Satisfied - Item:** Cover Letter  
**Comments:**  
**Attachment:**  
ARKANSAS.pdf

**Item Status:**  
**Status Date:**

**Satisfied - Item:** Report of Examination  
**Comments:**  
**Attachments:**  
Report of Examination (Part I).pdf  
Report of Examination (Part II).pdf  
Report of Examination (Part III).pdf

**Item Status:**  
**Status Date:**

**Satisfied - Item:** Response to Report of Examination  
**Comments:**

*SERFF Tracking Number:* FIVE-126307396      *State:* Arkansas  
*Filing Company:* 5 Star Life Insurance Company      *State Tracking Number:* 43518  
*Company Tracking Number:* 2007  
*TOI:* L08 Life - Other      *Sub-TOI:* L08.000 Life - Other  
*Product Name:* Report of Examination  
*Project Name/Number:* /

**Attachment:**

Report of Examination Response dated 05 29 2009.pdf



*Mildred E. Hunt  
Compliance Manager*

September 16, 2009

**VIA SERFF**

Mr. Mel Anderson  
Deputy Commissioner Financial Regulation, Finance  
Arkansas Insurance Department  
1200 West 3<sup>rd</sup> Street  
Little Rock, Arkansas 72201-1904

Re: *5 Star Life Insurance Company; NAIC: 77879; FEIN: 54-1829709*

Dear Mr. Anderson:

Enclosed please find a copy of 5 Star Life Insurance Company's Report of Examination as of December 31, 2007. The financial condition examination covers the period from January 1, 2003 through December 31, 2007.

Provided also is a Response to Examination as of December 31, 2007 dated May 29, 2009. Since SERFF has size restrictions on each document, the Report of Examination is divided into Parts I, II, and III.

If additional information is required, please feel free to contact me.

Sincerely,

A handwritten signature in blue ink, consisting of several overlapping loops and a long horizontal stroke extending to the right.

909 North Washington Street, Alexandria, VA 22314

(703) 706-5975  
(800) 776-2322 x2204

[mhunt@afba.com](mailto:mhunt@afba.com)



LOUISIANA DEPARTMENT OF INSURANCE

JAMES J. DONELON, COMMISSIONER

P.O. Box 94214  
BATON ROUGE, LOUISIANA 70804-9214  
PHONE (225) 342-5900  
FAX (225) 342-3078  
<http://www.lidi.state.la.us>

**ORDER ADOPTING REPORT OF EXAMINATION**

**OF**

**5 STAR LIFE INSURANCE COMPANY**

**AS OF**

**DECEMBER 31, 2007**

The above Report was completed by examiners of the Louisiana Department of Insurance.

The findings and conclusions of the Department regarding the status of the Company result from consideration of the review of the Report, relevant examiner workpapers, and any written submissions or rebuttals of the Company.

IT IS HEREBY ORDERED that the examination report be accepted, adopted, and filed as an official record of the Department.

James J. Donelon  
Commissioner of Insurance  
State of Louisiana

BY:

Caroline Brock, CFE  
Deputy Commissioner  
LA Department of Insurance

Dated this 24<sup>th</sup> day of April, 2009

**EXAMINATION REPORT**  
**OF**  
**5 STAR LIFE INSURANCE COMPANY**  
**BATON ROUGE, LOUISIANA**  
**AS OF**  
**DECEMBER 31, 2007**

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LOUISIANA DEPARTMENT OF INSURANCE  
JAMES J. DONELON, COMMISSIONER

P.O. Box 94214  
BATON ROUGE, LOUISIANA 70804-9214  
PHONE (225) 342-5900  
FAX (225) 342-3078  
<http://www.lidi.state.la.us>

March 12, 2009

Merle Schreiber, Director  
South Dakota Division of Insurance  
Department of Revenue and Regulation  
445 East Capitol Avenue, 1<sup>st</sup> Floor  
Pierre, South Dakota 57501-3185

Morris Chaves, Superintendent  
NM Public Regulation Commission  
Division of Insurance  
P.O. Drawer 1269  
Santa Fe, New Mexico 87504-1269

Joel Ario, Commissioner  
Commonwealth of Pennsylvania  
1326 Strawberry Square, 13<sup>th</sup> Floor  
Harrisburg, Pennsylvania 17120

James J. Donelon, Commissioner  
Louisiana Department of Insurance  
P.O. Box 94214  
Baton Rouge, Louisiana 70804-9214

Alfred W. Gross, Commissioner  
State Corporate Commission  
Bureau of Insurance  
Common Wealth of Virginia  
P.O. Box 1157  
Richmond, Virginia 23218

Gentlemen:

Pursuant to statutory provisions and in compliance with your instructions, an examination has been made of the affairs and financial condition of the

**5 Star Life Insurance Company**  
**Baton Rouge, Louisiana**

hereinafter referred to as the Company or 5 Star. The report thereon is submitted as follows:

## **SCOPE OF EXAMINATION**

Pursuant to LRS 22:1301 (redesignated to LRS 22:1981) of the Louisiana Insurance Code, this comprehensive financial condition examination covers the period from January 1, 2003 through December 31, 2007. This examination included any material transactions and/or events occurring during the examination period or subsequent to the examination date and noted during the course of the examination. Examination procedures included a verification of assets, a determination of liabilities, and reviews of income and disbursement items. The examination also included a review of the minutes of meetings of the board of directors; a review of related party transactions and agreements; a review of reinsurance transactions and agreements; and other records relating to the Company's operating practices.

Sampling techniques were employed when deemed appropriate. A management representation letter attesting to the Company's ownership of all assets and to the nonexistence of unrecorded liabilities or contingent liabilities was provided by the Company.

The examination began on March 31, 2008 and ended on January 31, 2009. Representatives from the Louisiana Department of Insurance performed the examination. We have relied upon the Louisiana Insurance Department's actuary, Mr. Rodney E. Friedy, FSA, MAAA regarding the accuracy of the valuation of the aggregate reserves and other actuarial items in the Company's statutory statement of liabilities as of December 31, 2007.

The examination was conducted at the Company's statutory home office and primary location of books and records at 909 North Washington Street, Alexandria, Virginia 22314.

During the course of the examination, the working papers of the Company's external audit firm were reviewed and relied upon as appropriate for the audit conducted as of December 31, 2007.

## COMMENTS AND RECOMMENDATIONS OF PREVIOUS EXAMINATIONS

The Company was last examined at December 31, 2002. The following comments and recommendations were taken from the previous examination report. Following each recommendation is a statement regarding the corrective action taken by the Company or findings of this examination:

1. **Holding Company Registration:** It is recommended that the Company report the Ultimate Controlling Person (UCP) as Lt. General Charles Cleveland Blanton, USAF (Retired), or the person occupying the Office of the President as Trustee of Armed Forces Benefit Association Voting Trust on all future filings as required with the Louisiana Department of Insurance. **Findings:** The Company reports the UCP as being AFBA Investment Trust, Sole Member of 5 Star Financial, LLC, Ralph E. Eberhart, Trustee.
2. **Market Conduct – Policy Forms:** It is recommended that policy applications and related certificate holder documents clearly identify the roles and relationship of AFBA, as the group policyholder, and 5 Star Life Insurance Company. **Findings:** 5 Star Life has revised all policy forms, applications, and related certificate-holder documents used by both AFBA and the Company for describing insurance coverage provided to AFBA members.

## HISTORY

### General

5 Star Life Insurance Company (“5 Star” or “the Company”), was organized May 24, 1943 as a service insurer providing funeral expense and hospitalization coverage. Originally, the Company’s name was Economy Service Insurance Company, which was domiciled in Lake Providence, Louisiana. In 1953 the Company changed its domicile to Bastrop, Louisiana and then to Shreveport, Louisiana in 1971. In 1967, the Company ceased issuing service policies. In 1968, the Company changed its name to United Agents Life Insurance Company of America. In

1969, the Company's Articles of Incorporation were amended to change the purpose of the Company to engage in the business of Life and Accident and Health Insurance.

The Bankers General Life Insurance Company was merged into the Company in 1984. In 1985 the Company's name was changed from United Agents Life Insurance Company of America to Western Fidelity Insurance Company. Also in 1985, the Company's domicile was changed from Shreveport, Louisiana to Baton Rouge, Louisiana.

On February 14, 1994, the Company, then known as Western Fidelity Insurance Company, was acquired by JMJ Financial Corporation through "Form A" proceedings as approved by the Louisiana Department of Insurance. Prior to the change in ownership an extraordinary dividend, as approved by the Louisiana Department of Insurance, in the amount of \$4,000,000 was paid to the former owners, Western Fidelity Financial Corporation.

Effective July 1, 1996, the Company, then known as Western Fidelity Insurance Company, was acquired by Armed Forces Benefit Services, Inc. through "Form A" proceedings as approved by the Louisiana Department of Insurance. Prior to the change in control, all business was ceded to National Group Life Insurance Company, New Era Life Insurance Company, and New Era Life Insurance Company of the Midwest essentially rendering the Company a "shell." Subsequent to the change in ownership, Article I of the Company's Articles of Incorporation was amended changing the Company's name to AFBA Life Insurance Company.

The Company's most recent Certificate of Authority, was amended effective October 26, 2000 for a name change from AFBA Life Insurance Company to 5 Star Life Insurance Company.

5 Star Life Insurance Company has principal administrative offices located at 909 North Washington Street, Alexandria, VA 22314 with its Statutory Home Office at 8440 Jefferson Highway, Suite 301, Baton Rouge, LA 70809.

### **Capital Stock**

The Company currently reports capital stock of \$2,500,050 representing 15,000 shares of voting capital stock with a par value of \$166.67 per share. The following table shows the initial capital stock and changes over the years:

<b>Date</b>	<b>Number of shares</b>	<b>Par Value</b>	<b>Amount</b>
May 24, 1943	150	\$ 10.00	\$ 1,500
July 23, 1969	1,000	\$ 100.00	\$ 100,000
June 26, 1984	10,000	\$ 100.00	\$ 1,000,000
December 23, 1985	12,000	\$ 100.00	\$ 1,200,000
February 1, 1988	15,000	\$ 100.00	\$ 1,500,000
September 24, 1996	15,000	\$ 166.67	\$ 2,500,050

At December 31, 2007, the Company's reported Capital and Surplus was \$52,274,557, which is greater than the \$300,000 minimum requirements of the Louisiana Insurance Code

### **Surplus Debentures**

The Company has not issued any surplus notes or surplus debentures during the period covered by this examination.

### **Dividends to Stockholders**

No dividends were paid during the examination period.

## MANAGEMENT AND CONTROL

### Board of Directors

The Articles of Incorporation and By-laws vest the management and control of the Company's business affairs with the Board of Directors elected annually. At December 31, 2007, the members of the Board of Directors and their business affiliations were as follows:

<b>Director</b>	<b>Principal Occupation</b>
Ralph Edward Eberhart Arlington, Virginia	President, Armed Forces Benefit Association Manager, 5 Star Financial, LLC Chairman of the Board, 5 Star Life Insurance Company Chairman of the Board, 5 Star Bank Chairman of the Board, AFBA Five Star Funds. Inc. Chairman of the Board, AFBA 5 Star Investment Management Company
Thomas Charles Lynch Villanova, PA	Managing Director – The Musser Group Senior Vice President, Safeguard Scientific, Inc. Director, 5 Star Life Insurance Company
James Roland Montgomery, III Ponce Inlet, FL	Retired Director, 5 Star Life Insurance Company Director, Vice Chairman, 5 Star Life Insurance Company
Thomas Egbert Moloney Boca Raton, FL	Retired, Consultant Director, 5 Star Life Insurance Company
Craig Sandin Piers Fairfax Station, VA	President, 5 Star Life Insurance Company  Director, 5 Star Life Insurance Company

Roger Charles Schultz Annandale, VA	President & Chief Operating Officer, Universal Systems & Technology  Senior Vice President, Army Operations, UNITECH  Director, 5 Star Life Insurance Company
Kimberley Elizabeth Wooding Springfield, VA	CFO & Executive Vice-President, 5 Star Life Insurance Company  Director, 5 Star Life Insurance Company
Theodore Glen Stroup, Jr. Falls Church, VA	Vice-President, Education Association of US Army  Director, 5 Star Life Insurance Company

Subsequent to December 31, 2007, James R. Montgomery, III retired from the Board effective January 1, 2009. Roger C Schultz resigned from the Board on January 1, 2009 due to AFBA enterprise-wide Board restructurings (he now serves on the AFBA Board). He was replaced by Larry K. Arnold on March 1, 2009.

### **Officers**

The officers holding office at December 31, 2007 were as follows:

President & Chief Executive Officer	Craig S. Piers
Exec. VP for Finance & Compliance	
Chief Financial Officer	Kimberley E. Wooding
Controller & Secretary	Maureen B. Ellner
General Counsel & Asst. Secretary	Marshal L. Cole
Sr. VP of Business Insurance Markets	Paul F. Monica
Sr. VP of Regional Operations	Michael K. Wong
Vice-President, Compliance	Glenn R. Jones
Vice-President, Regional Operations	Jane E. Kamm

Subsequent to December 31, 2007, an additional officer position was added. James R. Bradford was appointed as the Company's Vice President, Regional Operations on March 13,

2008. On January 28, 2009, Maureen B. Ellner, Vice President - Finance & Controller and Corporate Secretary, resigned. Glenn R. Jones was concurrently approved as the new Corporate Secretary in addition to his role as Vice President-Compliance. Gary L. Griffin was approved as the new Vice President - Finance & Controller on March 26, 2009.

### **Committees**

The Company has two primary committees that are approved by the Board of Directors and act on behalf of the Company on a routine basis. The Investment Committee is active in assessing the Company's investment philosophy, evaluates the performance of the investment managers, considers desirable investment vehicles, and reports to the Board. At December 31, 2007, the Investment Committee consisted of the following members:

Trustee of the AFBA Investment Trust	Ralph E. Eberhart
President & Chief Executive Officer	Craig S. Piers
Exec. VP for Finance & Compliance	
Chief Financial Officer	Kimberley E. Wooding
Controller & Secretary	Maureen B. Ellner
Consulting Actuary	John Miller

The Audit Committee is active in providing communications between the Company's independent accountants, senior management, internal audit and the Board of Directors. It serves as an independent and objective party to review the Company's financial reporting process and internal control structure as well as appraisal of the Independent Accountants and Internal Audit Department. At December 31 2007, the Audit Committee consisted of the following members:

Audit Committee Chairman;  
Director, 5 Star Life Insurance Co.

Thomas C. Lynch

Director, 5 Star Life Insurance Co.

James R. Montgomery III

Director, 5 Star Life Insurance Co.

Thomas E. Moloney

All actions taken by the Committees were approved and/or ratified by the board of Directors.

### **Conflict of Interest**

The Company has established a formal written "Conflict of Interest Policy" for directors and officers. However, the officers and directors do not sign updated conflict of interest statements on at least an annual basis. It is recommended that the Company ensure that its officers and directors sign an updated conflict of interest statement on at least an annual basis.

### **Investment Policy**

The Company has a written investment policy approved by the Board of Directors that provides guidelines for the Company's investments. The Company's investment strategy is to *"match the duration of its insurance liability requirements with a portfolio that supports a designated spread above the annualized crediting rates approved by the Investment Committee each quarter."* The investment strategy provides for a portfolio with an average duration of just below five years, primarily invested in marketable securities of investment-grade quality. The Company does not invest in derivative securities.

Two outside investment managers are utilized to manage the general account investment portfolio: AEGON USA Investment Management LLC and MFC Global LLC. The investment

policy requires the investment managers to abide by the specific requirements of the Louisiana Insurance Code, Section 844.

The Company outsources the tracking of trade activity to an external investment accounting provider, SunGard Insurance Systems, Inc. SunGard receives copies of trade tickets for all purchases and sales and agrees the tickets to the information provided by the investment manager and custodian to ensure that all transactions have been recorded.

The Company's "Valuation Policy and Procedures for Determination of 'Other than Temporary' Impairment of Securities" references FAS 115, but does not reference the NAIC Accounting Practice and Procedures Manual SSAP # 26, paragraph 9. The Company's policy indicates that for GAAP purposes any future improvements in a security that has been written down for impairment will be accreted on the adjusted cost basis of the security over the period remaining to the original maturity date. The policy does not indicate that for statutory purposes a security once written down cannot be written back up upon subsequent recoveries in fair value. It is recommended that the Company amend its policy to reference and be in compliance with SSAP # 26, paragraph 9.

### **Non-Affiliate Service Agreements**

The SunGard Insurance System, Inc. has had an Outsourcing Services Agreement with the Company since May 1, 2000. SunGard provides processing, record keeping and reporting of stock, bond and short-term investments. Fees are varied based on the number and type of services performed for the Company.

The Company also has Investment Management agreements with AEGON USA Investment Management LLC and MFC Global LLC (formerly John Hancock), who manages

and supervises the investment of certain assets of the Company with discretionary investment authority, subject to the Company's investment guidelines with an Investment Policy monitored by an Investment Policy Committee and approved quarterly by the Board of Directors. Fees are based on a rate per the fair market value of the portfolio per annum and/or other management services performed.

On August 1, 2003, the Company entered into a custodial agreement with Wachovia Bank, National Association. On December 30, 2005, Wachovia Corporation sold its institutional custody services business to U.S. Bank, National Association. On August 15, 2006, the Company consented to the transfer of its custodial business to U.S. Bank, National Association. No new custodial agreement was executed. The August 1, 2003 custodial agreement provides for the custodian to act at the request of the investment managers per the Company's agreement and authorization. The two investment managers are AEGON USA Investment Management LLC and MFC Global LLC. SunGard, the Company's investment accounting outsourcing company, records the investment activity per US Bank and the Company reconciles the activity with the investment managers.

The custodial agreement with U.S. Bank does not contain the required clauses of Regulation 83, sections 6 thru 11 and 15. It is recommended that the Company amend the custodial agreement to be in compliance with Regulation 83.

On May 31, 2005, the Company and Examination Management Services, Inc. (EMSI) entered into an Application Solutions Service Agreement whereby EMSI agreed to: (1) create electronic images of the Company's pre-approved insurance applications; (2) contact certain prospective insureds and through a telephone interview, elicit necessary information to prepare an insurance application; (3) forward a completed insurance application to the Company and the

prospective insured; and (4) provide a recommendation of underwriting action for the Company's review and final underwriting decision. The applications processed include the group level term policies between the Company and the affiliated Armed Forces Benefit Association (AFBA). In summary, the Company uses EMSI to perform all underwriting functions for the applications serviced such as processing policy applications and making underwriting recommendations. In consideration for the services provided, the Company agreed to pay EMSI monthly insurance application processing charges, which shall equal the number of various applications serviced in a month times the applicable charge per application. The term of the agreement is for two years with an automatic renewal for an additional year.

The Company has also engaged on a routine basis consultants for tax, audit, and actuarial services.

### **Third Party Administrators**

On December 1, 2005, the Company entered into an agreement with Transaction Applications Group, Inc. (TAG), a Perot Systems Company located in Lincoln, Nebraska. Considering that TAG collects premiums and settles claims, TAG can be considered a third party administrator as defined by LRS 22:3031 (redesignated to LRS 22:1641). TAG is licensed in Louisiana as a third party administrator.

TAG is responsible for the implementation and conversion process of managing approximately 14,000 policies written by 5 Star Life Insurance Company. In May 2006, the Company converted the processing of its work-site marketed programs (the Family Protection Plan) to TAG. The outsourcing of the servicing of the products is expected to leverage internal costs over time, as work-site marketed products are personnel-intensive and include many

manual processes. The administration of the Company's employer insurance program was also transferred to TAG's servicing group in August 2007.

The contract with TAG expires on December 1, 2010 unless extended upon mutual written agreement. The policies covered in the agreement include the Family Protection Plan and the Executive Protection Plan.

TAG is responsible for the following administrative services:

- issue new policies;
- reissue policies, endorsements, or riders;
- billing - process premium mailing to policyholders;
- accounting - account for premiums collected and reconcile outstanding checks, balance premiums collected and disbursements processed by TAG;
- commission accounting & payment - process agents' commissions for payment on a monthly basis.

In addition, TAG is responsible for the following policyholder services:

- policy changes;
- contract administration;
- policy reinstatement;
- interest rates;
- notice to policyholders required by policy;
- claims administration - receive notice of pending claims and pay claims except questionable claims will be forwarded to the Company;
- printing, forms, & formatting.

Both the Family Protection Plan Term to 100 and the MET (Multi-Employer Trust) Group Life books of business are fully administered by TAG except for the following processes noted below that are being handled jointly by the Company and TAG. Claims for both books of business are fully adjudicated and paid by TAG, however; all contestable claims are packaged

following adjudication and submitted to the Company for final signoff. On the MET Group life book of business, TAG utilizes the Company's underwriter. TAG submits any Over Guarantee Issue amount of coverage to the Company's underwriter for underwriting review. Following the review, the Company forwards an underwriting action worksheet to TAG who issues coverage at the requested face amount, reduces coverage to Guarantee Issue, or declines coverage outright. All underwriting correspondence is generated and handled by TAG.

### **Parent, Subsidiaries, and Affiliated Companies**

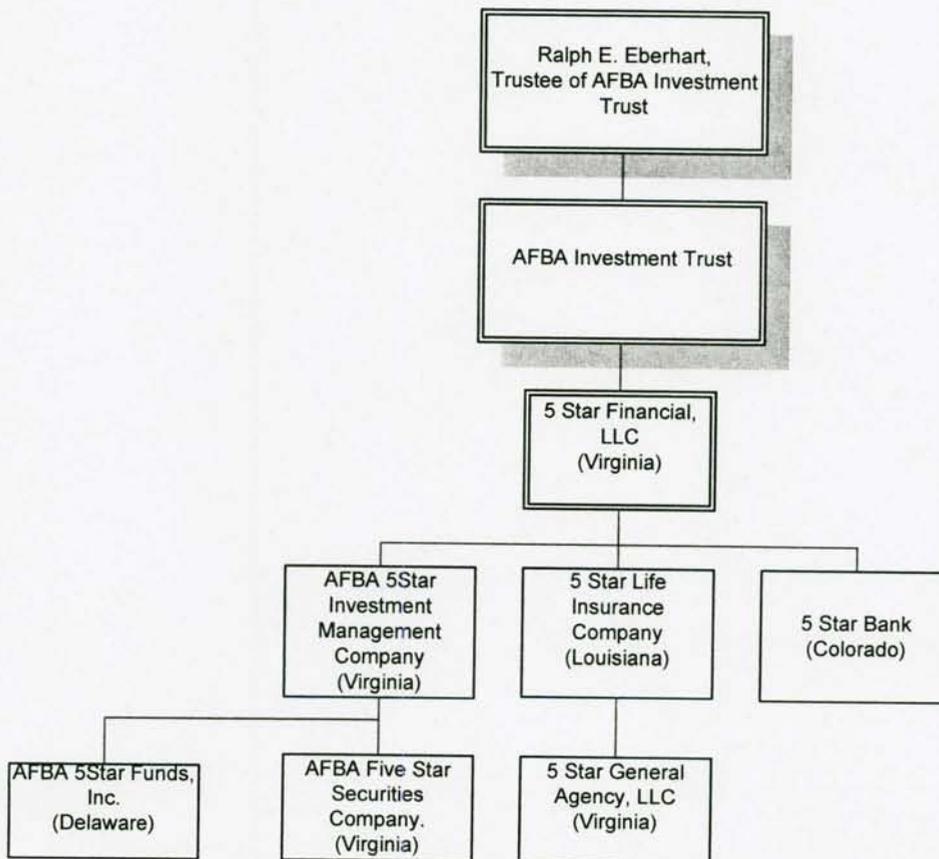
#### **Organizational Chart**

The Company is a member of an insurance holding company system pursuant to the Insurance Holding Company System Regulatory Law, LRS 22:1001 through 22:1015 (redesignated to LRS 22:691 to 22:713). The Company properly filed a Form B "Holding Company Registration Statement" per LRS 22:1005 (redesignated to LRS 22:703) for each year of the examination period.

The Ultimate Controlling Person (UCP) is the trustee of the AFBA Investment Trust, a trust, established on January 1, 2004 under the laws of the Commonwealth of Virginia. The Trust is between Armed Forces Benefit Association (AFBA), a tax-exempt 501(c) (9) voluntary employees' beneficiary association (VEBA), and the President of AFBA. The current trustee is Ralph Ed Eberhart, General, USAF (Retired). AFBA Investment Trust is the sole member/owner of 5 Star Financial, LLC, the immediate Parent of the Company. Under the terms of the Trust, the Trustee is authorized to exercise on behalf of AFBA and the Trust, all rights and powers with respect to the Trust Estate subject to the provisions of the Declaration of Trust.

The Armed Forces Benefit Association (AFBA) is a voluntary not-for-profit employees' beneficiary association established in 1947 by General Dwight Eisenhower to provide low cost life insurance to its members, primarily military personnel, during times of peace and war. Since 1950, John Hancock Mutual Life Insurance Company (MA) underwrote this life insurance. In 1996 John Hancock ceased writing the group insurance business and an agreement was reached with John Hancock that AFBA Life (now 5 Star Life) would assume the AFBA group business over a three-year period. AFBA contributed capital concurrently each year from 1997 to 1999 to support the business transferred.

The organizational chart as of December 31, 2007 is as follows:



**AFBA Investment Trust:**

The Trust was created in January 1, 2004 by the Armed Forces Benefit Association (AFBA) and the President of AFBA, retired General Ralph E. Eberhart. AFBA's president is empowered by the AFBA Board, through an investment trust arrangement, to carry out AFBA's overall mission statement as Chairman of the Boards of the related for-profit enterprises. He votes AFBA's ownership interests at the respective for-profit company meetings. AFBA is an unincorporated voluntary employees' beneficiary association (VEBA) established in 1947 for the purpose to provide life, health, accident, and other benefits to its members, their dependents or designated beneficiaries. Eligibility for membership includes all members of the Uniformed Military Services; Department of Defense, Department of Homeland Security and other Federal Government employees; Contractor Employees in support of the Uniformed Military Services; State and Local Employees (to include Police Officers, Firefighters and other First Responders); and their families. AFBA is under the leadership of a Board of Directors of senior active duty and retired military personnel.

**5 Star Financial, LLC:**

In March 1989, a holding company, now known as 5 Star Financial, LLC was formed as an umbrella organization to house operating for-profit companies. These companies are designed to provide to the general marketplace, including AFBA members, a full range of financial services including individual life insurance, banking services and mutual funds. 5 Star Financial, LLC is controlled by the AFBA Investment Trust. The holding company owns the building in Alexandria, VA where the majority of the subsidiaries reside.

**5 Star Bank:**

The 5 Star Bank operations are located within the state of Colorado, with its primary location being at the Peterson Air Force Base in Colorado Springs, Colorado. As military bases only allow one bank and one credit union on base property, the bank has a captive market at the base being one of two total financial institutions there. The bank was established in 1990 and is wholly-owned by 5 Star Financial, LLC, and provides customer retail banking, credit card services, home mortgage financing, and credit card processing for itself and other banks.

**5 Star Life Insurance Company:**

The Company was established in July 1996 and underwrites most of AFBA's group life insurance programs. In addition, the Company offers several individual life insurance products. The Company is the sole member/owner of its wholly-owned subsidiary, 5 Star General Agency, LLC.

**AFBA 5 Star Investment Management Company (IMCO):**

IMCO is an SEC regulated investment advisor whose sole purpose is to provide investment advice and managerial services solely to AFBA 5 Star Mutual Funds ("Funds"). In previous years the funds operated with one subadvisor, Kornitzer Capital Management; whereas recently the funds have moved towards using several subadvisors. IMCO has a wholly-owned subsidiary, AFBA 5 Star Securities Company ("the Broker Dealer"), which was established as a broker dealer to provide a distribution source for the Company for marketing the Funds. IMCO's primary revenue source is management fees, which it collects from the Funds.

**5 Star General Agency, LLC (Agency):**

The Agency is licensed in 50 states and the District of Columbia. The purpose of the Agency is for 5 Star Life to be able to offer products other than life insurance to the AFBA members. The Agency works with several companies to provide different types of financial products. The Agency currently has limited activity. 5 Star Life Insurance Company is a 100% member/owner of the Agency.

**AFBA Five Star Securities Company (the Broker Dealer):**

IMCO has a wholly-owned subsidiary, AFBA 5 Star Securities Company, which was established as a broker dealer to provide a distribution source for marketing the affiliated Funds. The Broker-Dealer's primary sources of revenue are service fees and distribution fees. It files audited financial statements with the Financial Industry Regulatory Authority (FINRA).

**AFBA 5 Star Funds, Inc. (Funds):**

The Funds are a family of mutual funds approved in 2006 by the Board of Directors of 5 Star Financial, in accordance with the Investment Company Act of 1940. IMCO manages all aspects of the Funds. It was originally organized as a Maryland corporation and will be reorganized as a Delaware Statutory Trust on July 31, 2008 and is registered with the U.S. Securities and Exchange Commission. The Trust is classified and registered as an open-end management company under the Investment Management Company Act of 1940. The Trust currently consists of six separate investment portfolios, each being a unique mutual fund.

**Armed Forces Benefit Association (AFBA)**

Armed Forces Benefit Association (AFBA) is a voluntary employees' beneficiary association (VEBA) which is a tax exempt organization under Internal Revenue Code Section

501(c)(9), organized to provide life, health, accident and other benefits to its members, their dependents or designated beneficiaries. Amounts anticipated to be expended for the benefits provided to members are contributed to the VEBA by its members and the VEBA provides for the payment of the benefits. Earnings on assets held in the VEBA generally accumulate tax free. Contributions to the VEBA which are reasonable and necessary to fund incurred but unpaid claims, including claims for life insurance benefits, are tax deductible. In addition to the group life insurance programs through 5 Star Life Insurance Company, AFBA offers to its membership supplemental health care insurance, long term care insurance, low interest rate credit cards, worldwide banking capabilities, no load mutual funds, home mortgages, homeowners' insurance, automobile insurance, automobile financing, travel services, tax deferred annuities, student loan programs, and an annual Financial Planning Guide. AFBA also conducts seminars and supports efforts to protect and improve benefits of military veterans. AFBA receives member contributions which includes the 5 Star Life group premium.

Armed Forces Benefit Association (AFBA) is the policyholder for the group life business and per the master policy, the premium is payable on the 45<sup>th</sup> day following each policy month to 5 Star Life (formerly AFBA Life). The policy stipulates that each policy month 5 Star Life will accept estimated premium based upon actual claims and estimated expenses. This is subject and limited to an accounting based on actual premium due, and an agreement between 5 Star Life and the policyholder (AFBA).

## **Affiliate Management and Service Agreements**

### **Premium Agreement for Term Insurance**

The premium agreement between 5 Star Life Insurance Company (insurer) and Armed Forces Benefit Association (policyholder) was initially entered into on May 1, 1997, amended and restated July 1, 2000 and July 1, 2001. The current agreement covers group term insurance programs under Policy # LT050197 and the group decreasing term program of Group Ultimate Select Term for Policy # G-UST100. AFBA, as policyholder, shall remit contracted premiums to 5 Star Life Insurance Company as the sum of:

- (a) claims incurred and related interest expenses;
- (b) retention charges of 3% of the collected policyholder member contributions;
- (c) the effective state premiums taxes; and
- (d) increases or decreases in Reserves determined under the Commissioners' Reserve Valuation Method and as required by the State of Louisiana.

Subparagraph (d) above provides for the \$10,074,771 accrued retrospective premium asset reported by the Company on its 2007 Annual Statement. Since this component of premiums due from AFBA increases and decreases based on the composition of the insurance in force, reserve factors and death claims, the Company and AFBA agreed to segregate this component from the Premiums Receivable asset. Amounts are calculated on a monthly basis and reviewed retrospectively after the end of each year, such that this component of premium is equal to the net reserves of the AFBA insurance offered under the Group Master Policy.

The criteria allowing the accrued retrospective premium asset was thoroughly reviewed, during the prior examination and subsequent examination review process, and determined to be in compliance with SSAP #s 4, 6, and 66. Pursuant to SSAP No. 66, amounts due from insureds

and amounts due to insureds under retrospectively rated contracts meet the definitions of assets and liabilities as set forth in SSAP No. 4. The SSAP goes on to state that once accrued retrospective premium is billed, the due date is governed by SSAP No. 6. The Louisiana Department of Insurance views this premium as retrospective premium and as such is admissible. Because of the amounts involved, the Department required 5Star Life to obtain a promissory note from AFBA for 100% of the asset, which stated that the amounts were due on demand.

The premium agreement also provides for the remittance to 5 Star Life for the effective state premium tax rates as defined by each state's tax regulations for the sum of (a) claims and (b) retention charges, including retaliatory taxes and municipal license taxes and fees.

The premium agreement requires an annual review of retrospective premiums for increase or decrease for remittance within 30 days following the termination of the agreement, or promptly upon written request from 5 Star Life, whichever occurs first.

In addition, AFBA as policyholder is to remit a conversion fee to 5 Star Life for each certificate under the policies covered by the agreement when converted to any other 5 Star Life insurance product.

The premium agreement provides that AFBA, as policyholder, guarantees, unconditionally, payment of premiums and conversion fees as stipulated in the agreement within 30 days of receipt of written notice from 5 Star Life. AFBA, as policyholder, represents and warrants that it has on hand cash funds and other liquid assets in amounts sufficient to collateralize fully all premiums payable to 5 Star Life Insurance Company. Earned premiums under the group life premium agreement for 2007 was approximately \$80,470,914 and \$74,743,378 for 2006.

In summary, AFBA provides its members with certificates of insurance under a master group life insurance policy (the Policy) between AFBA and the Company. The Policy renews annually and may only be terminated by the Company for non-receipt of premium. AFBA may terminate the Policy without cause with 30 days notice. AFBA uses a portion of its member contributions to pay premiums to the Company due on the Policy. The premium payments are calculated in accordance with a premium retention arrangement and are equivalent to the amount of claims incurred, increases in loss reserves during the period on the programs, and a retention fee. Under the terms of this premium agreement, premiums are limited in any given year to AFBA's annual membership contributions. AFBA has no obligation to pay premiums in excess of its annual membership contributions. However, any premium deficit may be carried forward by the Company for billing in subsequent periods to AFBA. The Company carries the risk that it will continue to pay death benefits under the Policy during the Policy year with no recoverability of any premium deficiency that might arise.

#### **Agreement to Provide Common Services Support and Pension Benefits**

5 Star Life, 5 Star Financial Co., AFBA, and AFBA 5 Star Investment Management Company entered into an "Agreement to Provide Common Services Support and Pension Benefits" effective April 1, 2001. The purpose of the agreement is to establish uniform and certain common or shared personnel/employees services and benefits, marketing, underwriting and administrative servicing activities, including claims processing services relating to the acquisition, and administration of certificate holder accounts. The Company is charged on a per certificate basis for acquisition costs and on the average in-force outstanding for processing and administration costs.

5 Star Financial Co provides personnel services to the Company. The cost of personnel services and support is shared on an equitable reimbursement basis on a time allocation per shared-employee. Pension benefits are reimbursed by the Company to AFBA on a pro-rata basis.

This agreement also provides for the marketing of 5 Star Life promotional materials in AFBA mailings to its members and prospective members and also includes the rental of office space by 5 Star Life, including operational pass through expenses.

The Company's costs incurred under this agreement to affiliates were \$331,505 for 2007 and \$241,794 for 2006.

#### **Data Processing Services Agreement**

The Company entered into an Agreement for Data Processing Services with 5 Star Bank on September 30, 1998 to provide remittance processing services to 5 Star Life Insurance Company.

### **CORPORATE RECORDS**

The Articles of Incorporation and Bylaws were reviewed. There were no changes to the Articles of Incorporation during the examination period. The By-Laws were amended four times during the examination period. The first change dated June 1, 2004 removed references to assistant vice presidents. The second change dated April 25, 2005 increased the minimum number of directors from three to five and increased the maximum number of directors from twelve to fifteen. The third change dated October 31, 2005 imposed an age limit of 75 years old for the board of directors. The fourth change dated September 8, 2006 allowed the board of directors to have a meeting via telephone.

## **FIDELITY BOND AND OTHER INSURANCE**

The Company is a named insured on a Financial Institution Bond which meets the minimum coverage recommended by the National Association of Insurance Commissioners (NAIC). The Company has coverage for employee dishonesty with a policy limit of \$1,000,000 and a \$50,000 deductible. In addition, the Company has a directors and officers liability policy with a limit of \$5,000,000 and a deductible of \$25,000. The liability limits exceed the \$800,000 to \$900,000 coverage suggested by the guidelines set by the NAIC Financial Condition Examiners Handbook.

## **OFFICERS', EMPLOYEES' AND AGENTS' WELFARE AND PENSION PLANS**

Pursuant to an agreement between Armed Forces Benefit Association (AFBA), the Company, 5 Star Financial, LLC and AFBA 5 Star Investment Management Company, 5 Star Financial has been appointed the Employer Agent for the Company under Section 3504 of the Internal Revenue Code for the purpose of payment of wages, remittance of payroll taxes and backup withholding. The Company reimburses 5 Star Financial for the payment of wages and related remittances incurred on behalf of the Company. The Company reimburses AFBA for its pro-rata share of the pension plans.

The Company offers its employees two retirement plans. The two plans are offered through the ultimate parent, AFBA, and cover substantially all employees of AFBA and its subsidiaries. In addition, there is an additional retirement plan available to executive and highly paid management.

AFBA sponsors a defined benefit plan (the AFBA Plan) covering substantially all employees of AFBA and its subsidiaries. The benefits are based on years of service and the employee's compensation during the last five years of employment. AFBA's funding policy is to make the minimum annual contributions required by applicable regulations, and to charge each subsidiary for its allocable share of such contributions based on a percentage of payroll. Employees are vested after five years of service. The Company's allocated expense was \$253,878 and \$222,013 for the year ended December 31, 2007 and 2006, respectively.

Since November 1, 1985, the Company participates in a voluntary defined contribution incentive savings plan available to all eligible employees of AFBA and its subsidiaries upon completion of three months of service. Employees' contributions are matched by the Company up to a maximum of 5% of the participant's based compensation. The Company contributed \$133,424 and \$89,033 to the Plan in 2007 and 2006, respectively.

Effective January 1, 2007, the Company became a plan participant in an unfunded nonqualified supplemental executive retirement plan (SERP) sponsored by 5 Star Financial for certain executive management employees and highly compensated employees. SERP benefits are supplemental to the vested benefits payable to the eligible employees under the AFBA Plan, and are based on the eligible employee's compensation during the last five years of employment. The Company accrued for its estimated liability under the plan \$32,296 and \$53,960 for years 2007 and 2006, respectively.

The Company does not offer post-retirement benefits.

## **INSURANCE PRODUCTS AND RELATED PRACTICES**

### **Territory and Plan of Operations**

The Company is a Louisiana domiciled life insurance company that is currently licensed in 49 states, the District of Columbia, Puerto Rico, the Virgin Islands, Guam, American Samoa, and the Northern Mariana Islands. The Company is also authorized by the Department of Defense to sell to military service members in European and Pacific Region commands. 5 Star Life is a member of the consolidated group of 5 Star Financial, LLC that provides insurance, banking, and investment services to the members of AFBA. The Company is rated "A-(Excellent) by A.M. Best Company.

### **Products**

The Company offers a variety of group term products to military families, federal civilian employees, and state, municipal and government contractor employees. The Company also offers similar individual life insurance products outside of the military/government market, and has developed term products available for the employer and work-site markets, as well as the final expense arena. Additionally, the Company sells permanent insurance in the form of universal life, interest sensitive whole life, and traditional whole life on both a group life and an individual basis. The Company offers both preferred (including ultra-preferred) and standard underwriting classes for most of its new products, but does not write substandard business.

Until January 1, 2006, 5 Star Life provided a group Tricare health insurance supplement product called 5 StarCare. Tricare is the Department of Defense's ("DoD") managed health care program for active duty and retired military families, and replaced the original Champus healthcare program. 5 Star Life's 5 StarCare program offered various plan options and deduction

levels to match Tricare's different service plans, including "Tricare for Life", which services members over age 65, replacing the need for certain Medicare supplement programs.

In 2005, 5 Star Life determined that the supplemental healthcare business line fell outside of the Company's business strategy and risk model. Therefore, in November 2005, the Company entered into a definitive agreement to sell the majority of its 5 StarCare program to Hartford Life & Accident Insurance Company for \$700,000 in cash, effective January 1, 2006. The remaining certificates that were not sold were terminated at the end of the program's plan year on October 1, 2006, and the claims run-off period expired on September 30, 2007.

### **Marketing and Distribution**

The Company has structured its internal marketing and distribution group to align with its business lines. By separating 5 Star Life's target sales groups into separately focused divisions with independent managers, the Company's goal is for its sales efforts to reach the appropriate audiences more efficiently and in a more effective manner. The distribution divisions are separated into three groups:

- Association (AFBA) Market Sales – focuses on sales of term insurance products to AFBA's membership population, as well as sales to other military affinity programs;
- Individual Insurance Market Sales – focuses on the sale of term insurance and smaller face whole life policies in the general marketplace. Sales of 5 Star Life's simplified-issue traditional whole life that is targeted to the final expense market are also included in this group;

- Business Insurance Market Sales - focuses on the sale of work-site marketed insurance plans, as well as group employer insurance for employee benefit packages.

5 Star Life's primary distribution channel within each division is through an independent sales force. This field distribution is structured around 33 regional sales directors ("RSD's"), with the majority of RSD's in the group insurance division. The RSD's are responsible for recruiting, training, meeting and developing sales objectives, local conflict resolution, and marketing for their region. The RSD's are paid a commission override for performing these duties. Approximately 808 agents report to these RSD's. Agents in the group division focus their sales efforts outside of military bases, training facilities, and service academies, as well as regions where there is a high military or Federal civilian population. 5 Star Life has also formed relationships with the National Guard and state guard associations to gain further access to potential members.

Agents in the Individual and Business markets are selected because of their specialized affiliations in the niche markets that each division has targeted. The Company has targeted sales of its business market products through direct work-site marketing through agents, as well as by connecting with brokers in the employer group market. 5 Star Life has built affinity primarily among teacher and hospital employee groups in the Midwest and Southern U.S., in smaller cities where the larger insurance companies do not typically market.

The Company has also formed business partnerships with underwriters such as CIGNA International Benefits Group (CIGNA), where group employer life insurance programs are dually-marketed by CIGNA brokers. Such arrangements typically involve underwriting Department of Defense contract employees involved in government contracts in war-risk zones.

In addition to direct sales contacts through agents, 5 Star Life also distributes its products via the Internet and direct mail. The Company has developed an on-line application system for certain products, whereby potential customers and agents can utilize the Internet to complete insurance applications and sign by electronic signature. Additionally, "jet-issue" programming has been designed for certain products with minimal underwriting requirements.

The Company is currently researching the development of a Return of Premium Product that would be marketed primarily to the AFBA membership. Additionally, development is in process for a stand-alone critical illness product to add to the business insurance programs.

### **Underwriting**

All of the Family Protection Plan (FPP) and the group life multiple employer trust business is fully underwritten by Transaction Applications Group, Inc. (TAG) pursuant to an agreement dated December 1, 2005. However, the majority of the Company's business, which is all of the group level term policies between the Company and AFBA, is underwritten by Examination Management Services, Inc. (EMSI) pursuant to an agreement dated May 31, 2005. EMSI performs all underwriting functions for the applications serviced such as processing policy applications and making underwriting recommendations; although, the final decision is made by the Company.

5 Star Life provides simplified underwriting for the Company's final expense product, Silver Premier Whole Life. In addition, the following policies are underwritten in-house: (1) Group Ultimate Select Term; (2) Individual Ultimate Select Term; (3) State Sponsored Life Insurance; (4) Better Alternative applications that do not require a paramedical exam; and (5) all children Level term and Individual Universal Life applications.

The Company's Internal Audit Division completed an operational and compliance audit of EMSI's medical underwriting operations for 2006 including an on-site review in Waco, Texas that was completed in February 2007. Using PriceWaterhouseCoopers control testing guidelines for testing manual controls that occur at a frequency of multiple times per day, a sample size of 60 applications was selected. The Internal Audit Division concluded that EMSI has adequate controls in place and adheres to contractual requirements so as to minimize business risks.

A separate underwriting audit was conducted by Swiss Re at 5 Star Life Insurance Company on May 22 – 25, 2006. A total of 178 cases were reviewed which included lives aged 24 to 70 with face amounts ranging from \$100,000 to \$500,000. The policies in the sample were all issued in 2005. The audit focused on risk assessment, adherence to underwriting guidelines, compliance with preferred criteria and adherence to treaty, automatic binding and jumbo limits. Case development and file documentation were also evaluated. Swiss Re judged the underwriting based upon the Company's adherence to Swiss Re's Life Guide underwriting manual, which is 5 Star's manual of record and 5 Star's internal underwriting guidelines. The audit concluded that case documentation was brief but present on nearly all cases. The underwriters adhered to the age and amount guidelines. Second opinions on borderline findings were obtained appropriately. The Medical Director reviewed all EKGs for the on-site underwriters. There were only two exceptions out of the sample of 178.

### **Policy Forms**

The Company regularly seeks Louisiana Department of Insurance approval for new policy forms and applications. For example, in 2007 the Company received three filing approvals that included six enrollment forms, four applications, two supplemental applications, a group master policy, a certificate, and four amendments.

### **Treatment of Policyholders**

The examination sampled and reviewed 39 of the 2007 claims. The claims sampled were processed in a fair and reasonable manner, in accordance with policy provisions and LRS 22:656 (redesignated to LRS 22:1811). The Department of Insurance has not received any complaints against the Company during the last three years. The Company received a few complaints directly from the policyholders. The examination sampled those complaints and found that the Company responded timely and treated the policyholder fairly.

### **Claims Administration**

AFBA assesses and processes life insurance claims for its members regardless of the underwriter, and had performed this function for almost 40 years for John Hancock Life Insurance Company. AFBA is now under contract to perform similar functions for 5 Star Life, following underwriting guidelines set by 5 Star Life.

The Company's policies include a \$15,000 emergency death benefit that is paid to the beneficiary immediately upon notification of an insured's death. AFBA's claims department generally pays the remaining life insurance benefits within twenty-four hours of receiving all appropriate supporting information. Claims investigation is outsourced to a private investigator when considered necessary, and litigated claims are assigned to outside counsel.

In 2006, 5 Star Life's underwriting process was moved to EMSI, based in Waco, Texas. EMSI performs underwriting through telephone interviews with potential customers, and reviews all lab and medical information using on-site medical staff. Underwriting recommendations are based on 5 Star Life's underwriting guidelines, and are submitted to 5 Star for ultimate approval.

## **REINSURANCE**

### **Reinsurance Assumed**

Effective July 1, 1996, the Company assumed, under a 100% coinsurance agreement, reserves and assets of \$23.7 million related to the permanent universal and interest sensitive whole life business underwritten by John Hancock Mutual Life Insurance Company (now John Hancock Life Insurance Company) under the AFBA contracts. Effective January 1, 1997, the 100% coinsurance agreement was cancelled for the states in which the Company is licensed and writing on a direct basis. The agreement is currently effective only for AFBA members in New York since the Company is licensed in all states except New York. Premiums earned under this agreement during 2007 were \$103,297 with reserves of \$1,292,835 and an inforce amount of \$8,200,000.

### **Reinsurance Ceded**

In September 2001, the Company entered into a 50% coinsurance treaty with Lincoln National Life Insurance Company, now known as Swiss Re, to reinsure the risk of underwriting certain guaranteed level premium term insurance programs. The treaty was retroactively adopted to July 1, 2000, and coinsures both group and individual term plans through automatic underwriting up to \$500,000. A second treaty with Swiss Re was entered into in August 2005 for all new sales of the guaranteed level premium term program. Total reserve credits applied from these treaties were \$24.9 million at December 31, 2007. Total insurance in force ceded under these contracts were \$1.8 billion at December 31, 2007.

In September 2004, the Company entered into a group accidental death and dismemberment carve-out quota-share reinsurance contract with Hartford Life to cede 100

percent risk (up to \$250,000 per incident) of accidental death and dismemberment policies that are offered in conjunction with the sale of voluntary group life policies in the employer market. Ceded insurance in force at December 31, 2007 under this program was \$129 million for group accidental death and dismemberment. No reserve credits are recorded under this treaty.

### **STATUTORY AND SPECIAL DEPOSITS**

LRS 22:1028 (redesignated to LRS 22:808) requires Louisiana insurance companies to deposit with the Commissioner, a safekeeping receipt showing that the company has on deposit \$100,000 held in trust for the benefit of all policyholders and creditors of the insurer. The Company had U. S. Treasury Notes in the amount of \$5,349,669 on deposit with the Louisiana Department of Insurance pledged to the Commissioner of Insurance, for the benefit of all policyholders.

Additionally, the Company has placed securities on deposit with a book value of \$3,887,682 to meet statutory requirements of other states and territories in which the Company is licensed. These deposits are for the benefit of the particular state or territory's policyholders. The deposits are with the following states and/or territories: Arkansas, Georgia, Massachusetts, New Mexico, North Carolina, South Carolina, Virginia, American Samoa, Guam, Puerto Rico, and the US Virgin Islands.

## ACCOUNTS AND RECORDS

### General

The Company utilizes a network system with AFBA using IBM AS/400 Mainframes, Novell software Servers, and Microsoft NT/XP/2000 servers. Ancillary software applications are developed by the Company on a proprietary basis including an in-house developed "Inquiry 400" program, "Claims Reporting System 400" program, and "Insurance Database 3 Dimensional" (ID3) program and various insurance specific software products.

Some systems are outsourced such as the AXIS program, which is outsourced to the Company's actuaries, Miller & Newberg, Inc., and includes the tracking and reserving of the select term products. The processing, recordkeeping, and reporting of stocks, bonds, and short-term investments is outsourced to SunGard. Additional services provided by Sungard include preparation of the Schedule D and DA, detailed reports for general ledger journal entries, reconciliation of custodian's records with the portfolio, calculation and preparation of IMR/AVR reports, calculation of amortization, interest accrual, and journal entries.

The accounting records are maintained on the Lawson General Ledger System that includes the accounts payable subledger and all general ledger reporting. Checks are printed using the Procheck system, which interfaces with Lawson's accounts payable subledger. The annual statement preparation software is by Booke and Company.

Accounting activity for policy-related general ledger accounts (e.g., premiums, commissions, surrenders, etc.) is generated by the ID3 Policy Administration System. General Ledger activity from ID3 is electronically posted to the Lawson General Ledger on a monthly basis via a mapping program. Trial balance summaries of the general ledger accounts are

manually typed into an Excel spreadsheet to adjust from the modified cash basis of accounting to the statutory basis of accounting (non-ledger entries).

The Company homepage is at [www.afba.com](http://www.afba.com). Online business transactions are performed through the website with electronic signatures provided by Synex and online credit card transaction security provided by Authorize.net. Secure certificates for encryption are through VeriSign.

There is no written agreement or contract for use by IT of a specific alternate site and computer hardware to restore data processing operations after a disaster occurs. The Company plans to upgrade its data center in Colorado to house redundant equipment with replication between the sites to become a true hot site. It is recommended that the Company establish a hot site that would enable the Company to resume operations in the event of a disaster.

The Company employs the services of an independent certified public accounting firm and independent actuary to perform its fiscal year end audit and the required independent statutory financial reports for the Company and its subsidiary.

### **Internal Control Deficiency**

In 2007, 5 Star Life identified a material misstatement in the December 31, 2006 premium tax accrual and restated the December 31, 2006 statutory financial statements. The Company did not sufficiently analyze the accrued premium tax expense account which lead to the delayed identification of an over accrual that accumulated over previous reporting periods. The over accrual was determined to be \$1.555 million gross of federal income taxes. The over accrual is material to net income; however, since the adjustment would increase surplus levels, and in itself does not materially change surplus, the Department did not require the Company to amend the 2006 Annual Statement. The Department allowed the Company to report the

correction of the balance as an adjustment to 2006 Unassigned Funds (Surplus) in the 2007 Annual Statement. The adjustment net of taxes is reported in Note 2 "Accounting Changes and Corrections of Errors" of the 2007 Annual Statement's "Notes to Financial Statements."

The Company is now using Tritech's Premium Pro software to fully calculate the tax liability, and should be able to determine the liability shortly after the end of each financial closing period.

### **COMMITMENTS AND CONTINGENCIES**

The Company, along with its parent, 5 Star Financial, has entered into an agreement with SunTrust Bank to provide a guarantee for up to \$20,000,000, for contractual obligations under a line of credit available to AFBA. There were no amounts carried as liabilities for the Company's obligations under this guarantee at December 31, 2007.

Effective March 4, 2008, the Company has an unsecured line of credit with SunTrust Bank in the amount of \$10,000,000. The line of credit may be used for cash liquidity purposes and has a termination date of March 31, 2009 and has since been renewed through September 30, 2009.

## **FINANCIAL STATEMENTS**

Financial statements included in this report are as follows:

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Reconciliation of Capital and Surplus	41

The notes to these financial statements follow and are considered an integral part thereof.

**5 Star Life Insurance Company**  
**Statement of Assets**  
**As of December 31, 2007**

	Assets	Nonadmitted Assets	Admitted Assets
Bonds	\$ 122,521,494		\$ 122,521,494
Stocks: preferred stocks	562,731		562,731
Stocks: common stocks	947,362		947,362
Cash and short-term investments	9,249,281		9,249,281
Contract loans	5,440,418		5,440,418
Other invested assets	724,921	153,071	571,850
Investment income due & accrued	1,471,052		1,471,052
Uncollected premiums	12,056,134		12,056,134
Accrued retrospective premiums	10,074,771		10,074,771
Amounts recoverable from reinsurers	1,040,072		1,040,072
Other amts. recv. under reins. contracts	150,310		150,310
Net deferred tax asset	5,585,092	4,581,834	1,003,258
Guaranty funds receivable	62,957		62,957
EDP equipment and software	206,592	29,992	176,600
Furniture and equipment	472	472	-
Receivables from parent, sub., & affil.	647,984	1,990	645,994
Aggreg. w/-ins for other than inv. assets	2,627,844	2,627,650	194
Totals	<u>\$ 173,369,487</u>	<u>\$ 7,395,009</u>	<u>\$ 165,974,478</u>

**5 Star Life Insurance Company**  
**Statement of Liabilities, Surplus, and Other Funds**  
**As of December 31, 2007**

Aggregate reserve for life contracts	\$	95,040,719
Contract claims: life		10,077,328
Premiums received in advance		71,674
Interest Maintenance Reserve		1,077,758
Commissions to agents due or accrued		912,563
Commissions payable on reinsurance assumed		51
General expenses due or accrued		1,402,182
Taxes, licenses, and fees due or accrued		1,561,288
Federal income taxes		665,546
Unearned investment income		132,487
Remittances and items not allocated		159,696
Asset valuation reserve		856,175
Payable to parent, subsidiaries, and affiliates		648,481
Aggregate write-ins for liabilities		1,093,973
		<hr/>
Total liabilities		113,699,921
		<hr/>
Common capital stock		2,500,050
Gross paid in and contributed surplus		44,421,049
Unassigned funds (surplus)		5,353,458
Less treasury stock, at cost:		<hr/>
Total capital and surplus - <b>Note 1</b>		52,274,557
		<hr/>
Total Liabilities, Surplus, & Other Funds	\$	<u><u>165,974,478</u></u>

NOTE: Minimum required capital pursuant to LRS 22:71	\$ 100,000
Minimum required surplus pursuant to LRS 22:71	200,000
Minimum required capital and surplus per LRS 22:71	<u><u>\$ 300,000</u></u>

**5 Star Life Insurance Company**  
**Statement of Summary of Operations**  
**For the Year Ended December 31, 2007**

Premiums and annuity considerations	\$ 91,755,506
Net investment income	7,379,176
Amortization of interest maintenance reserve	\$ 104,664
Commissions & expense allowances on reinsurance	\$ 1,707,102
Aggregate write-ins for miscellaneous income	<u>2,937</u>
TOTALS	<u>100,949,385</u>
Death benefits	72,001,469
Diability benefits under A&H contracts	19,899
Surrender benefits and withdrawals for life con	1,256,536
Increase in aggregate reserves	<u>9,215,796</u>
TOTALS	82,493,700
Commissions on premiums and annuity considerati	7,180,299
Commissions & expense allow. on reinsurance ass	4,558
General insurance expenses	6,619,007
Insurance taxes, licenses, and fees	<u>3,281,713</u>
TOTALS	<u>99,579,277</u>
Net gain from operations before dividends to policyholders and federal income taxes	1,370,108
Dividends to policyholders	<u>-</u>
Net gain from operations after dividends to policyholders and before federal income taxes	1,370,108
Federal income taxes incurred	<u>129,442</u>
Net gain from operations after dividends to policyholders and federal income taxes and before realized capital gains or (losses)	1,240,666
Net realized capital gains or (losses)	<u>(139,164)</u>
Net Income	<u><u>\$ 1,101,502</u></u>

**5 Star Life Insurance Company**  
**Reconciliation of Capital and Surplus**  
**From January 1, 2003 to December 31, 2007**

	2003	2004	2005	2006	2007
Capital and surplus, December 31, previous year	\$ 49,131,864	\$ 48,980,787	\$ 49,318,833	\$ 50,104,265	\$ 51,817,421
Net Income	151,897	1,142,354	1,075,577	662,221	1,101,502
Change in net unrealized capital gains (losses)	156,108	70,101	(9,740)	73,701	(86,372)
Change in net unrealized foreign capital losses					(9,985)
Change in net deferred income tax	182,410	809,308	263,009	454,989	294,829
Change in non-admitted assets	(417,126)	(1,136,325)	(371,844)	(597,610)	(862,414)
Change in AVR	(224,366)	(547,392)	(171,570)	109,883	19,576
Capital changes: paid in	50				
Surplus adjustment: paid in	(50)				
Aggregate write-ins: prior period adjustment				1,009,971	
Rounding				1	
Net change in capital and surplus for the year	(151,077)	338,046	785,432	1,713,156	457,136
Capital and surplus, December 31, current year	\$ 48,980,787	\$ 49,318,833	\$ 50,104,265	\$ 51,817,421	\$ 52,274,557

## NOTES TO FINANCIAL STATEMENTS

### Note 1 – Capital and Surplus

\$ 52,274,557

Pursuant to LRS 22:71 (redesignated to LRS 22:81), the Company is required to maintain capital of \$100,000 and surplus of \$200,000 for a combined capital and surplus requirement of \$300,000. The Company's \$52,274,557 capital and surplus balance exceeds the statutory minimum requirements of LRS 22:71 (redesignated to LRS 22:81).

## **SUMMARY OF COMMENTS AND RECOMMENDATIONS**

### 1. **Page 9 – Management and Control – Conflict of Interest**

It is recommended that the Company ensure that its officers and directors sign an updated conflict of interest statement on at least an annual basis.

### 2. **Page 10 – Management and Control – Investment Policy**

The Company's "Valuation Policy and Procedures for Determination of 'Other than Temporary' Impairment of Securities" policy indicates that for GAAP purposes any future improvements in a security that has been written down for impairment will be accreted on the adjusted cost basis of the security over the period remaining to the original maturity date. The policy does not indicate that for statutory purposes a security once written down cannot be written back up upon subsequent recoveries in fair value. It is recommended that the Company amend its policy to reference and be in compliance with SSAP # 26, paragraph 9.

### 3. **Page 11 – Management and Control – Non-Affiliate Service Agreements**

The custodial agreement with U.S. Bank does not contain the required clauses of Regulation 83, sections 6 thru 11 and 15. It is recommended that the Company amend the custodial agreement to be in compliance with Regulation 83.

4. **Page 35 – Accounts and Records**

There is no written agreement or contract for use by IT of a specific alternate site and computer hardware to restore data processing operations after a disaster occurs. It is recommended that the Company establish a hot site that would enable the Company to resume operations in the event of a disaster.

## **SUBSEQUENT EVENTS**

In the fourth quarter of 2008 the capital markets experienced a substantial decline in market value. It is noted that the Company has exposure to the capital markets via its investments in bonds and stocks. During 2008 the Company wrote down its bonds and preferred stock by \$6,167,707 for an “other than temporary impairment.”

Decisions regarding other-than-temporary impairments have become less certain today given current market conditions. As market liquidity has dried up, the Company's market values have become more dependent on broker quotes and proprietary pricing models underlying them, rather than recently observable market trades which would better reflect a “true” market value.

## CONCLUSION

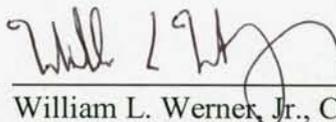
I, William L. Werner, Jr., do solemnly swear and affirm that I am an examiner for the Commissioner of Insurance of the State of Louisiana and that as such I was assigned to make an examination of the affairs and financial condition of

### **5 STAR LIFE INSURANCE COMPANY OF LOUISIANA BATON ROUGE, LOUISIANA**

That I made such examination and the above and foregoing is a true and correct copy of my report of such company and the same is true and correct to the best of my knowledge, information and belief.

The following individuals participated in the examination and join the undersigned in acknowledging the courteous cooperation of the Company's officers and employees:

- Rodney E. Friedy, FSA, MAAA, the Department of Insurance's Director of Life Actuarial Services;
- Dave Ramsey, FSA, MAAA of Allen Bailey and Associates;
- Anthony Infantini, ASA, MAAA of Allen Bailey and Associates; and
- Mary T. Dampman, CFE, CIE, CPA, FLMI, CPCU, CLU, MCM
- Lillie Pryer



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William L. Werner, Jr., CFE  
Louisiana Department of Insurance

May 29, 2009

Mr. Steve Brown  
Financial Analyst  
Office of Financial Solvency  
P.O. Box 94214  
Baton Rouge, LA 70804-9214

RE: Response to Examination of 5 Star Life Insurance Company as of 12/31/2007

Dear Mr. Brown:

This letter acknowledges our receipt of the Report of Examination of 5 Star Life Insurance Company as of December 31, 2007 ("the Report"), which was received in our offices on May 19, 2009. Our responses to the recommendations summarized on page 43 of the Report are provided as follows:

1. *It is recommended that the Company ensure that its officers and directors sign an updated conflict of interest statement on at least an annual basis.*

The Company implemented procedures in 2008 to have the officers and directors sign a Conflict of Interest Statement annually.

2. *The Company's "Valuation Policy and Procedures for Determination of 'Other than Temporary' Impairment of Securities" policy indicates that for GAAP purposes any future improvements in a security that has been written down for impairment will be accreted on the adjusted cost basis of the security over the period remaining to the original maturity date. The policy does not indicate that for statutory purposes a security once written down cannot be written back up upon subsequent recoveries in fair value. It is recommended that the Company amend its policy to reference and be in compliance with SSAP # 26, paragraph 9.*

While the Company's Other than Temporary Impairment (OTTI) Policy does reference the accreting of future improvements in the value of a security under GAAP, there were no securities for which accretion was deemed appropriate prior to December 31, 2008. Effective January 1, 2009, the Company has adopted SSAP No. 99, "Accounting for Certain Securities Subsequent to an Other-than-Temporary Impairment," which supercedes SSAP No. 26, paragraph 9, and adopts the GAAP treatment of accreting future improvements in securities that have been written down for impairment. The Company's OTTI Policy has been amended to reference SSAP No. 99.

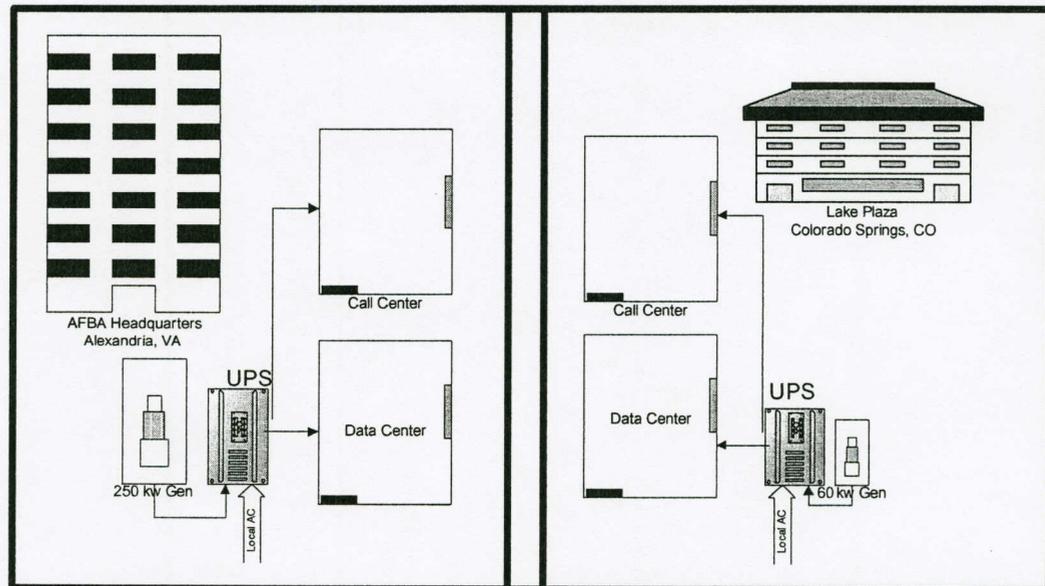
3. *The custodial agreement with U.S. Bank does not contain the required clauses of Regulation 83, sections 6 thru 11 and 15. It is recommended that the Company amend the custodial agreement to be in compliance with Regulation 83.*

5Star Life will obtain a revised custodial agreement from U.S. Bank that is in accordance with Regulation 83 before December 31, 2009.

4. *There is no written agreement or contract for use by IT of a specific alternate site and computer hardware to restore data processing operations after a disaster occurs. It is recommended that the Company establish a hot site that would enable the Company to resume operations in the event of a disaster.*

As an enterprise associated with Armed Forces Benefit Association (AFBA), 5 Star Life shares in the services of the AFBA Information Technology (IT) Department. AFBA enterprises have locations in both Alexandria, Virginia (administrative offices for 5 Star Life) and Colorado Springs, Colorado (administrative offices and branches for 5Star Bank). The AFBA IT Department Strategic Plan was published on January 8, 2009 in which the following information was referenced:

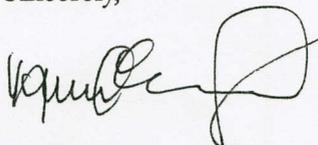
"The physical location of the AFBA enterprises has allowed the creation of a cost effective survivability strategy. We are utilizing the two largest facilities [Alexandria and Colorado Springs] to house core system components and piggyback on the need to provide emergency power and computing to the contact centers housed in each of these locations. The recent build out of the [5Star Bank] data center in the Lake Plaza building [in Colorado Springs, CO] (along with the move of [5Star Bank] contact center personnel to that location) is the first step in the realization of a physically separate disaster recovery site for AFBA HQ [Alexandria, VA]. Conversely, AFBA HQ will be able to act as the disaster recovery site for much of Colorado operations. Figure 1 shows a high level view of the two data centers."



May 29, 2009

We sincerely appreciate the thorough review that your examination team has performed on our Company, and the assistance that you and your staff have provided to us during this process. Please give me a call at 703-299-5794 or send me an email at [kwooding@afba.com](mailto:kwooding@afba.com) if you would like to discuss any of these responses.

Sincerely,

A handwritten signature in black ink, appearing to read 'Kimberley E. Wooding', with a large, stylized flourish at the end.

Kimberley E. Wooding  
Executive Vice President - Finance and Compliance,  
Chief Financial Officer

cc: Caroline Brock, Louisiana Deputy Commissioner