

**BEFORE THE INSURANCE COMMISSIONER
FOR THE STATE OF ARKANSAS**

**IN THE MATTER OF THE
REPORT OF EXAMINATION OF
FOUNDATION LIFE INSURANCE
COMPANY OF ARKANSAS**

AID NO. 2007- 005

ADOPTION ORDER

Now on this day the matter of the Report of Examination ("Report" or "Report of Examination") as of December 31, 2005 of Foundation Life Insurance Company of Arkansas ("Foundation" or "Company"), of Little Rock, Arkansas, NAIC #83992, a domestic stock insurance company, is taken under consideration by Julie Benafield Bowman, Insurance Commissioner for the State of Arkansas ("Commissioner"), as presented by the Chief Counsel – Legal Division, Ms. Jean Langford, and the Finance Division of the Arkansas Insurance Department ("Department"). From the facts, matters and evidence before her, the Commissioner finds as follows:

FINDINGS OF FACT

1. That the Commissioner has jurisdiction over the Company and the subject matter involved herein.
2. That the Company is an Arkansas-domiciled stock insurance company authorized to transact life insurance and accident and health (disability) insurance in the State of Arkansas on the stipulated premium plan pursuant to Ark. Code Ann. §§ 23-71-101, et seq., among other laws.

3. That the Department issued Consent Order No. 2001-035, dated and signed in counterparts on January 18, 2001 and on January 23, 2001. The Consent Order acknowledged the circumstances for the Company's most recent change in control; that upon the death of the majority stockholder, Mr. Robert B. Westphal, on May 18, 1999, his shares of stock were legally vested in Mrs. Betsey J. Westphal. The Order approved the change in control of the Company to Mrs. Betsey J. Westphal, as majority stockholder.

4. That, pursuant to Ark. Code Ann. §§23-61-201, et seq., §23-71-103(2), and other applicable laws, the Commissioner authorized and directed the Department to conduct a regular examination of the affairs, transactions, accounts, records and assets of the Company as of December 31, 2005. The examination was conducted in accordance with *The Examiner Handbook* of and the Accounting Practices and Procedures Manual ("APPM") of the National Association of Insurance Commissioners ("NAIC").

5. That said examination was commenced by the Department on August 21, 2006, and completed on October 13, 2006.

6. That the verified Report of Examination was filed with the Department on December 6, 2006; it was then forwarded to the Company via certified mail on December 6, 2006. The Report was received by the Company on December 8, 2006, according to the certified mail return receipt returned to the Department.

7. That the Report of Examination contains the following comments on discrepancies or deficiencies concerning the Company's operations:

a) The Examiners stated that, during the period under examination, the Company's policy and contract claims reserve in the amount of \$33,404 was

understated by approximately \$158,000. An examination adjustment was made in order to increase the policy and contract claims reserve; and to decrease net income and unassigned funds by \$158,000;

b) That the Department's contract actuary determined the Company improperly reported that it had no stipulated premium policies in force in the Annual Statement, under Exhibit 5, *Interrogatories*. This finding did not result in a financial statement adjustment because the Company is not required to carry reserves on the policies issued prior to January 1, 1968, in accordance with Department Rule 62, *Reserves for Funeral Expense Insurance*. It was determined that the Company's current reserves are adequate;

c) That the Company improperly admitted real estate assets exceeding the twenty percent (20%) of the total admitted asset limitation defined in Ark. Code Ann. § 23-63-828, *Real Estate*, applicable to stipulated premium plan insurers under Ark. Code Ann. §23-71-103(6), and exceeding the amount permitted for any prior consent of the Commissioner by approximately \$30,000. The Company was notified of this error by the Department subsequent to the examination date; and the Company properly non-admitted the overage in the First and Second Quarter, 2006 statutory financial statement filings. An examination adjustment was made to non-admit the over-investment in real estate and to decrease unassigned funds by \$30,000;

d) That the Company improperly understated its Asset Valuation Reserve ("AVR") liability by approximately \$22,000; resulting from a computational error in the Company's calculation of the AVR reserve objective and maximum reserve

as defined by the NAIC's APPM, SSAP No. 7, *Asset Valuation Reserve and Interest Maintenance Reserve*. An examination adjustment was made to increase the AVR liability and to decrease unassigned funds by \$22,000; and

e) The Examiners noted that the Company was not depleting its investment holdings of oil and gas mineral rights in accordance with *Generally Accepted Accounting Principles* ("GAAP"). The examination determined that the fair market value of the Company's total mineral right assets appears to be well in excess of the book-adjusted carrying value per the Annual Statement. Therefore, this finding did not result in a financial statement adjustment.

8. That the Report of Examination contains a "SUBSEQUENT EVENTS" section, wherein the Examiners stated:

a) In January 2006, the Company contributed real estate property with a book value of \$63,793 (before encumbrances of \$16,659) and an estimated \$585,118 fair market value to a limited liability corporation ("LLC"), in return for a forty-five percent (45%) member ownership interest in the newly-formed company (the LLC);

b) An affiliate of the Company contributed additional real estate, located directly adjacent to the Company's contributed property, and managerial expertise to the LLC, in return for receipt of membership documents constituting the remaining ownership interest in that LLC.

c) The newly-formed LLC has agreements to improve and develop the real estate property for commercial use. The Company's contribution was accounted for in accordance with the NAIC's APPM, SSAP No. 25,

Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties, without material exception. However, the transaction did not include the appropriate disclosures per the NAIC's APPM, SSAP No. 25; and the transaction required, but did not receive, the prior written consent of the Insurance Commissioner, in non-compliance with Ark. Code Ann. § 23-63-833(2), *Prohibited Investments*; and

d) The Company filed the transaction with the Department subsequent to the examination, and the transaction was under review as of the issuance of this examination report. The Department subsequently issued its letter of December 27, 2006; therein acknowledging the transactions, and advising or directing the Company to file in writing its proposals for similar future transactions with the Department in advance, in order to receive the Commissioner's written consent and approval, as the Arkansas laws require.

9. That the Company sent the Department no written rebuttal or discussion letter in reply as to any Examiner comments on discrepancies or deficiencies.

THEREFORE, pursuant to the provisions of Ark. Code Ann. §23-61-205 (Supp. 2005) and §23-71-103(2), the Commissioner hereby orders:

A. That the Examination Report, as filed with the Department is hereby adopted;

B. That the Company shall take the following remedial steps and measures:

1) The Company shall ensure that its policy and contract claims reserves include claims in the course of settlement ("ICOS"), and claims incurred but not reported

("IBNR"), in accordance and proper compliance with the NAIC's APPM, SSAP No. 55, *Unpaid Claims, Losses and Loss Adjustment Expenses*; as required by Ark. Code Ann. §23-63-601, applicable to stipulated premium plan insurers under Ark. Code Ann. §23-71-105(a)(2);

2) The Company shall monitor its in-force stipulated premium policies and its annual Actuarial Opinion should include disclosure of the number of policies, the amount of insurance in force, and the premiums collected on those policies for the year under review. The Actuarial Report should comment on any premium deficiencies related to the pre-1968 policies, for which there are no aggregate reserves. In addition, the Company shall properly complete the Exhibit 5, *Interrogatories*, in all future Annual Statement filings in compliance with Ark. Code Ann. §23-63-216(Supp. 2005), applicable to stipulated premium plan insurers under Ark. Code Ann. §23-71-103 (3);

3) The Company shall not acquire additional real estate assets that result in it exceeding the investment limitations per Ark. Code Ann. §23-63-828 or other applicable investment limitations, applicable to stipulated premium plan companies under Ark. Code Ann. §23-71-103(6), or pursuant to other applicable Arkansas laws or rules requiring prior permission granted in writing by the Insurance Commissioner with proper, written notice to the Department in advance of the transaction;

4) The Company in compliance with its reserve requirements under Ark. Code Ann. §§23-63-601, et seq., applicable to stipulated premium plan insurers under Ark. Code Ann. §23-71-105, shall ensure the accuracy and completeness of its Asset Valuation Reserve in future financial statement filing, in accordance with the NAIC's APPM, SSAP No. 7, *Asset Valuation Reserve and Interest Maintenance Reserve*, and the

NAIC Quarterly and Annual Statement Instructions in compliance with Ark. Code Ann. §23-63-216 (Supp. 2005), applicable to stipulated premium plan insurers under Ark. Code Ann. §23-71-103 (3), or other applicable insurance laws or rules;

5) The Company shall deplete its mineral right asset values over the remaining productive life of the associated oil and gas reserves in accordance with *GAAP* formulas in its future financial statement filings under Ark. Code Ann. §23-63-216 (Supp. 2005), applicable to stipulated premium plan insurers under Ark. Code Ann. §23-71-103 (3), and any other applicable Arkansas laws and rules; and

6) The Company shall comply with the NAIC's *Accounting Practices and Procedures Manual*, as well as any applicable Arkansas laws and rules, on accounting practices and procedures for disclosure of affiliate transactions and investments;

C. That the Department shall forward a copy of this Order and the adopted Examination Report to the Company, by certified mail. The mailing to the Company shall include specimen affidavit forms for the Company's Directors to use in acknowledgement that each member of the Board received the adopted Report of Examination and this Order, pursuant to Ark. Code Ann. §23-61-205(b)(1)(Supp. 2005), applicable to stipulated premium plan companies under Ark. Code Ann. §23-71-103(2);

D. That within twenty (20) days of receipt of this Order and the adopted Examination Report, the Company shall file with the Department the affidavits executed by each one of its Directors, stating under oath or affirmation that each has received a copy of this Order and adopted Examination Report, pursuant to Ark. Code Ann. §23-61-205(b)(1)(Supp. 2005), et seq., applicable under Ark. Code Ann. §23-71-103(2);

E. That the adopted Examination Report shall be open for public inspection upon the expiration of thirty (30) days from the Company's receipt of this Order pursuant to Ark. Code Ann. §23-61-205(c)(Supp. 2005); and

F. That the Department, as a matter of course, reserves the right to consider administrative proceedings at a later date for areas of Insurance Code or of Commissioner's rule non-compliance alleged against Foundation Life Insurance Company of America in the current Report of Examination; although at this time, none are contemplated.

IT IS SO ORDERED THIS 1st DAY OF February, 2007.


JULIE BENAFIELD BOWMAN
INSURANCE COMMISSIONER
STATE OF ARKANSAS