

Government of Puerto Rico  
OFFICE OF THE COMMISSIONER OF INSURANCE

**National Life Insurance Company of Puerto Rico**  
Examination Report Amended  
as of December 31, 2009

Yoani Ditrén Acosta  
Examiner

Yajaira Torres Martínez  
Examiner Assistant

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GOVERNMENT OF PUERTO RICO  
OFFICE OF THE COMMISSIONER OF INSURANCE

June 29, 2011

Ana María López Erquicia, Esq.  
Chief Deputy Commissioner  
Guaynabo, Puerto Rico

Dear Mrs. López Erquicia:

In compliance with your instructions and pursuant to the Order Number EX-2010-177 dated July 30, 2010, and the Puerto Rico Insurance Laws and Regulations, a comprehensive risk focused examination and financial affairs examination was made of the books, records, and financial condition of:

**National Life Insurance Company**  
510 Muñoz Rivera Ave.  
San Juan, Puerto Rico 00918

Wherever the designations "the Company" or "NALIC" appear herein without qualification, it should be understood to indicate the National Life Insurance Company. Wherever the designation "Department" appears herein without qualification, it should be understood to indicate the Puerto Rico Insurance Department. The examination was conducted at the Company's main administrative office located at 510 Muñoz Rivera Avenue, Suite 200, Hato Rey, Puerto Rico.

## SCOPE OF EXAMINATION

This examination covered the period from January 1, 2007, through December 31, 2009. Also, transactions occurring subsequent to this period were reviewed where deemed appropriate, by the examiner.

The examination comprised a complete verification of assets and liabilities as of December 31, 2009. The examination included a review of income, disbursements and company records deemed necessary to accomplish such verification, and utilized, to the extent considered appropriate, work performed by the Company's independent certified public accountants ("CPA").

This report was a statutory financial examination conducted in accordance with the Financial Condition Examiners Handbook, Accounting Practices and Procedures Manual and Annual Statement Instructions promulgated by the NAIC, with due regard to the statutory requirements of the insurance laws and rules of the Commonwealth of Puerto Rico.

The Financial Condition Examiners Handbook requires that the examination be planned and performed to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation and management's compliance with Statutory Accounting Principles and Annual Statement

Instructions when applicable to domestic state regulations. A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations in the prior report on examination.

This report on examination is confined to financial statements and comments on those matters, which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

### **HISTORY**

The Company was incorporated on June 3, 1969, under the provisions of the Insurance Code of the Commonwealth of Puerto Rico and its operations consist principally of underwriting individual and group life and credit life insurance, individual annuities and accident and health insurance contracts. The Company was a member of a holding company system, with the ultimate controlling parent, National Promoters & Services, Inc., owning the majority portion of the Company. Substantially all of the business is conducted in Puerto Rico.

Under applicable Puerto Rico Insurance Laws and Regulations, the Company is required to maintain minimum capital and surplus of \$2,500,000. The minimum capital and surplus requirement was amended during December 2004 and allows the Company a five year period to increase its capital. The Company declared stock dividends for the amount of \$166,360 in December 31, 2008. Dividends can be paid from unassigned surplus without prior approval of the Department.

As of December 31, 2009, the Company has 500,000 share of \$10 par value common stocks authorized and \$250,291 shares issued and outstanding. The Company

has 300,000 shares of \$10 par value preferred stock authorized and none issued or outstanding.

On March 30, 2005, the Company issued \$5.0 million in surplus notes to develop surplus funds for statutory purposes in exchange of cash. The underwriter of these notes was Dekania Capital Management LLC and the trustee is JP Morgan. These notes have been reported as surplus since these are subordinated to policyholders, claimant and beneficiary claims and to all other classes of creditors other than the surplus notes holders. The Commissioner approved the surplus notes as to form and content on March 25, 2005. Although the notes provide a stated interest rate (at 3 month Libor plus 3.7% with a cap of 12% on March 30, 2010), the Company is required to request permission to the Commissioner prior to repaying such surplus notes as well as paying interest on them. Accordingly, interest is not recorded as a liability nor as an expense until approval for payment of such interest has been granted by the Commissioner.

On March 31, 2005, the Company issued \$5.0 million in notes to develop surplus funds for statutory purposes in exchange of shares of common stock. The notes were issued to National Promoters & Services, Inc., a related party. These notes are reported as surplus since these are subordinated to policyholders, claimant and beneficiary claims and to all other classer of creditors other than the surplus notes holders. The Commissioner approved the surplus notes as to form and content on March 31, 2005. On March 30, 2009, the Company repaid the notes after obtaining proper authorization from the Commissioner. During 2009, the Company recorded interest expense on

surplus notes issued to unrelated parties amounting to \$249,210. Approval for such payments was received from the Commissioner prior to disbursement.

During 2008, the Department has permitted Company to capitalize the home office real estate investment at market value as determined by a certified appraiser. Real Estate investments represent properties occupied by the Company and are presented as adjusted by the market value adjustment made in 2008, under special acceptance by the Commissioner net of encumbrances, if any, and the accumulated depreciation of the cost of the property. The useful life of real estate was estimated at approximately 40 years.

In 2009, the Company does not obtain prior approval from the Commissioner to capitalize the home office real estate investment.

On June 22, 2009, AM Best Company, change the Company's classification (A -) to (B + +) with a negative outlook. Among the reasons given for such a change, include the decline of the surplus of the Company.

On June 15, 2010, AM Best Company, degraded again Company's classification (B + +) to (B +) with a negative outlook. On this occasion, the ratios of those taken for degradation are the poor operating performance and underwriting losses.

## **MANAGEMENT AND CONTROL**

### **Board of Directors**

Pursuant to the Section 29.160(2) of the Insurance Code of Puerto Rico and Company's by-laws, management of the Company is vested in a board of directors, consisting of not less than five (5) nor more than fifteen (15) members. The board met at

least four (4) time during each calendar year. At December 31, 2009, the board of directors was comprised of the following eleven members:

<b>Name</b>	<b>Title</b>
Carlos M. Benítez, Jr.	Chaiman
Lcdo. Virgilio Ramos González	Director
Edgardo Van Rhyn	Director
Edgar Rodríguez Gómez	Secretary/Treasurer
Lcdo. Fernando Rivera Munich	Director
Lcdo. Juan B. Soto Balbás	Director

### **Officers**

Pursuant to the Section 29.210 of the Insurance Code of Puerto Rico and the Company's by-laws, the Board of Directors (Board) appointed the officers. At December 31, 2009, the officers are comprised of the following:

<b>Name</b>	<b>Title</b>
Carlos M. Benítez, Jr.	President of the Board of Directors
Edgardo Van Rhyn	President and CEO
Edgardo Rodríguez Gómez	Secretary and Treasurer
Luis F. Rivera Flores	Vice President Senior
Manuel Julbe	Vice President Senior
Edgardo Betancourt	Vice President Senior
Ricardo L. Reguero	Vice President Senior
Yolanda Márquez	Vice President
María Nelly Collazo	Vice President
Lourdes Guzmán Carmona	Vice President

**Internal Committees**

The Company's Board appointed several internal committees in accordance with Section VI of Company's by laws. Following were the principal internal committees and their members as of December 31, 2009:

<b>Name</b>
Carlos M. Benítez, Jr.
Edgardo Van Rhyn
Edgar Rodríguez Gómez
Luis F. Rivera Flores

**CORPORATE RECORDS****Minutes**

The minutes of the Board, shareholder and certain internal committees were reviewed for the period under examination. A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member had an acceptable record of attendance.

**Conflict of Interest**

The Company has a procedure to distribute conflict of interest questionnaires to its board of directors, executive officers and to all principal employees on a yearly basis. A review of the Company's records was made for the period covered by this examination. This review was confined to the board of directors listed in the annual statements covered by this examination period.

## **TERRITORY AND PLAN OF OPERATION**

As of December 31, 2009, the Company was licensed to write business in Puerto Rico and Florida State. As of the examination date, the Company was authorized to transact with two kinds of insurance life, and disability. Based on the lines of business for which the Company is licensed and Company's current capital structure, and pursuant to the requirements of Section 3.090 of the Insurance Code of Puerto Rico, the Company is required to maintain a minimum surplus to policyholders in the amount of \$2,500,000.

### **Statutory Deposit**

Pursuant to Section 3.151 of the Insurance Code of Puerto Rico, \$1,320,000 are deposited with the Department and the State of Florida in trust for the protection of the Company's policyholders and creditors, as required by the respective insurance codes

## **AFFILIATED COMPANIES**

The Company is a party to numerous inter-company agreements, with its affiliates, which are subject to the Department's review and approval. These agreements involve activities such as administrative services. The most significant of those agreements is the management agreement between National Promoters & Services, Inc. (NAPROSERV) and the Company.

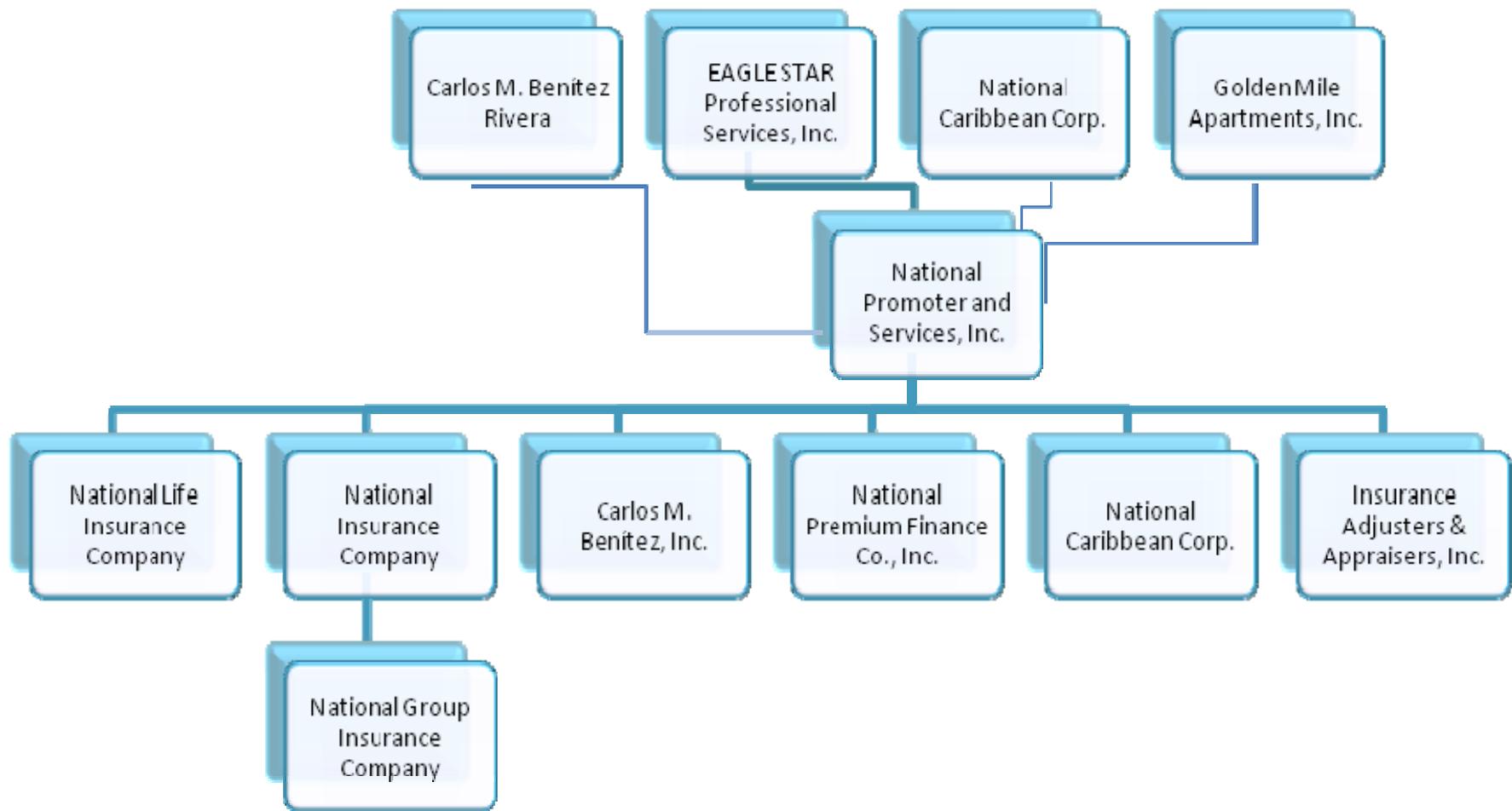
NAPROSERV provides the following consulting services to the Company: financial, management, accounting, employee management and benefit, information systems and other general and administrative services. The Company pays NAPROSERV a monthly management fee for providing these services.

During the period covered by this examination, the Company made payments according to the set out in the contract, as occurs below:

<b>Years</b>	<b>Amount</b>
2009	\$1,560,000
2008	1,560,000
2007	<u>1,680,000</u>
Total	\$4,680,000

In addition, the Company has an agreement with Inscom Systems, Inc., an affiliate to provide consulting services related to general electronic data processing. The Company paid Inscom approximately \$594,576 for these services during the 2009. Also during 2009 the Company entered into an agreement with Option Healthcare Network, Inc., to provide consulting services related to claim services and processing.

The Company was a member of an insurance holding company system. A simplified organizational chart as of December 31, 2009, reflecting the holding company system, is shown below.



## **REINSURANCE**

The Company cedes all risk in excess of \$250,000 on individual life and credit life insurance and \$75,000 for Group life and credit life insurance. For accident and health, the Company cedes 85% of the risk for all Long-Term Disability (LTD) policies. Presently, the Company is doing business with six reinsurance company, one of which reinsurance exclusively LTD.

Premiums and Commissions related to insurance ceded are accounted for as a reduction of premiums written and acquisition and commission costs, respectively. Reinsurance recoveries are recorded as a reduction of life and accident and health benefits incurred.

## **RETIREMENT BENEFITS**

The Company's employees participate in the retirement benefit plan of Carlos M. Benítez, Inc. (an affiliate). The plan is qualified non-contributory defined benefit pension plan (the Plan) covering all employees who have one year of service and have met certain age requirements. The Plan was frozen as of December 31, 2004. The Company is required to make annual contributions to the Plan, as determined by consulting actuaries, which should be at least the minimum funding requirement of ERISA. In 2009, the Company charged to operations its annual contribution amounting to \$105,312. At January 1, 2009, latest actuarial valuation date, the Plan's total accumulated benefit obligation determined in accordance with ERISA regulations based on an assumed rate of return of investments of 7% was \$11,831,243, including vested benefits of \$11,831,243, and the Plan's assets were \$9,282,318. Plan assets consist mainly

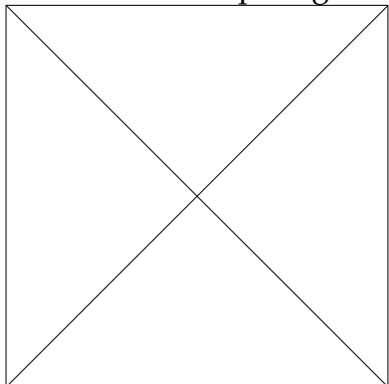
of U.S. Government securities, bonds, stocks, cash and cash surrender values on life insurance policies. Separate data for the Company's employees are not available.

Effective September 1, 2004, the Company established a qualified savings plan under section 1165(e) of the Puerto Rico Internal Revenue Code of 1994, as amended. It covers substantially all employees who have completed three months of service and have reached the age of eighteen. For the years ended December 31, 2009 and 2008, the Company made matching contributions that amounted to \$42,718 and \$44,670.

### SUBSEQUENT EVENTS

The Company is subject to legal proceedings and claims in the ordinary course of business. On March 12, 2008, the General Agency J.A. González, Inc., ("JA"), filed a lawsuit against the Company on account of alleged violation of contract and contractual impairment to violate their exclusive right to sell cancer insurance (Vital 360), under Law 75 of June 24 1964. On December 2, 2009, the Court of First Instance, ("the Tribunal") issued an Order which resolved and determined, inter alia, that:

- The pre-agreement made between the Company and JA on September 12, 1995, gives the market exclusivity on the sale of cancer insurance policies with the characteristics described in the pre-agreement.



- The Company is ordered to immediately cease and desist from the sale of policies (Vital 360 & Platinum) unless it is managed and coordinated by JA.

On March 19, 2010, the Company and JA, made a private agreement, ("the Agreement") which provided, inter alia:

- The Company will pay to JA, the sum of \$ 2,540,000, which included costs and attorney fees, two (2) deadlines.

The Company did not make the disclosure required by SSAP No. 9 paragraph five (5), presented an estimate or provision on the amount to be paid as a subsequent of the agreement.

During April 2010, the Company received a subpoena for documents from the Puerto Rico. Department of Justice (PRDOJ) requesting information principally related to the Asociación de Compañías de Seguros de Puerto Rico, Inc. (ACODESE by its Spanish acronym). The Company ceased to be a member of ACODESE, an insurance trade association established in Puerto Rico in 2007.

The Company believes similar subpoenas and information request were issued to other member and former member companies of ACODESE in connection with the investigation of alleged payments by the former Executive Vice President of ACODESE to members of the Puerto Rico Legislative Assembly beginning in 2005. The Company, however, has not been informed of the specific subject matter of the investigations being conducted by the PRDOJ. The Company is fully complying with the subpoenas and the request for information intends to cooperate with any related government investigation.

## **INFORMATION SYSTEMS**

The Company's Information Systems ("IS") portion of the examination was performed in accordance with the Handbook, utilizing the new Exhibit C (Evaluation of Controls on Information Technology) approach. The examiners' review of IS control included: IS management and organizational controls, system and program development controls, overall systems documentation, contingency planning, local and wide area network and mainframe controls.

As a result of the procedures performed, the examination team obtained reasonable assurance that Information Technology ("IT") general controls and general application controls were functioning as management intended and that an effective system of internal control is in place and conducive to the accuracy and reliability of financial information processed and maintained by the Company.

However, the examiners noted certain reportable items related to the review of IS controls.

## **FINANCIAL STATEMENTS**

The following pages contain financial statements showing the Company's financial position and results of its operations. These statements are the same filed annual statement as of December 31, 2008 and 2009:

**National Life Insurance Company**  
 Balance Sheet  
 As of December 31, 2009 and 2008

	<b>YEARS</b>	
	2009	2008
<b>ASSETS</b>		
Bonds	\$96,696,660	\$99,407,418
Preferred Stocks	258,804	280,094
Common Stocks	6,085,831	7,579,329
Mortgage Loans – First liens	6,769	230,283
Real Estate	11,726,723	11,804,284
Cash and Cash Equivalents	2,476,078	6,722,696
Contract Loans	3,321,420	3,773,082
Other Invested Assets	2,865	0
Investment Income Due and Accrued	975,072	899,349
Uncollected Premiums	13,233,664	6,672,319
Amounts Recoverable from Reinsurers	4,048,573	4,167,586
Electronic Data Processing	608,847	890,351
Aggregate write-ins for Other Assets	5,867,164	4,160,443
Total Activos	\$145,308,470	\$146,587,234
<b>LIABILITIES</b>		
Aggregate Reserve for Life Contracts	\$87,652,446	\$83,893,256
Aggregate Reserve for Accident and Health Contract Claims	11,762,081	14,514,170
Life	5,200,185	2,953,691
Accident and Health	11,550,302	7,611,204
Interest Maintenance Reserve	864,583	682,923
Commissions to agent due	399,739	311,384
General Expenses Due or Accrued	844,898	1,130,224
Taxes, Licenses and Fees	297,155	275,575
Current Federal and Foreign Income Tax	74,242	5,354
Unearned Investment Income	117,726	137,814
Amounts withheld or Retained	356,259	292,756
Amounts held for agent's Account	1,496,455	1,358,567
Remittances and Items not Allocated	211,456	265,882
Asset Valuation Reserve	2,278,704	2,513,962
Aggregate write-ins for Liabilities	1,966,055	2,113,055
Total Liabilities	\$125,072,286	\$118,059,817
<b>CAPITAL</b>		
Common Capital Stock	\$2,502,910	\$2,502,910
Surplus Notes	5,000,000	10,000,000
Gross Paid and Contributed Surplus	3,860,873	3,860,873
Unassigned Funds	8,872,401	12,163,634
Capital and Surplus	\$20,236,184	\$28,527,417
Total Liabilities, Surplus and other Funds	\$145,308,470	\$146,587,234

**National Life Insurance Company**  
Statement of Income  
As of December 31, 2009 and 2008

	2009	2008
Premiums and Annuity	\$95,342,997	\$71,504,785
Net Investment Income	5,704,793	5,873,283
Amortization of Interest Maintenance Reserve	102,638	24,374
Commissions and Expense Allowances	0	287,134
Miscellaneous Income	403,792	182,626
	<u>\$101,554,220</u>	<u>\$77,872,202</u>
Death Benefits	11,956,824	7,018,448
Annuity Benefits	222,662	147,390
Disability Benefits and Benefits under Accident & Health	41,015,739	24,742,971
Surrender Benefits and Withdrawals for Life Contracts	6,494,377	4,843,080
Group Conversions	6,745	0
Interest and adjustment on Contract or Deposit	5,428	523
Increase in Aggregate Reserve	2,350,255	4,756,557
	<u>\$62,052,030</u>	<u>41,508,969</u>
Commissions on Premiums and Annuity	11,186,323	12,170,910
Commissions and Expense Allowance	2,960,760	2,380,292
General Insurance Expenses	20,430,787	17,285,867
Insurance Taxes, Licenses and Fees	742,486	743,484
Increase in Loading on Deferred and Uncollected Premiums	4,263	(3,548)
Aggregate write-ins for Deductions	2,661,525	2,483,671
	<u>100,038,174</u>	<u>76,569,645</u>
Net Gain from Operations before Income Taxes	1,516,046	1,302,557
	<u>(77,635)</u>	<u>(590,415)</u>
Net Income	<u>\$1,438,411</u>	<u>\$712,142</u>

## National Life Insurance Company

### Cash Flows

As of December 31, 2009 and 2008

	2009	2008
<b>CASH FROM OPERATIONS</b>		
Premium Collected net of Reinsurance	\$86,921,970	\$71,567,287
Net Investment Income	5,634,325	6,209,100
Miscellaneous Income	403,792	469,760
	\$92,960,087	\$78,246,147
Benefit and Loss Related Payments	54,740,324	33,681,411
Commissions, Expenses paid for Deduction	38,157,273	34,032,463
Federal and Foreign Income Taxes Paid	(68,888)	(5,354)
	92,828,709	67,708,520
Net cash from Operations	131,378	10,537,627
<b>CASH FROM INVESTMENTS</b>		
Proceeds from Investment:		
Bonds	22,639,345	27,691,711
Stocks	1,472,209	(255,435)
Mortgage Loans	198,070	104,553
Net Losses	0	(928,511)
Miscellaneous	102,629	2,654,097
	24,412,253	29,266,426
Cost of Investments Acquired		
Bonds	19,771,242	36,376,803
Stocks	0	1,936
Mortgage Loans	223,514	0
Real Estate	25,068	5,439,359
Miscellaneous	30,261	1,627
	20,050,085	41,819,725
Net cash from Investments	\$3,910,506	(12,551,477)
<b>CASH FROM FINANCING &amp; MIS. SOURCE</b>		
Surplus Notes	(5,000,000)	
Other Cash	(3,288,502)	(2,258,675)
	\$(8,288,502)	\$(2,258,675)
Net cash from Financing & Mis. Source	\$(8,288,502)	\$(2,258,675)

**National Life Insurance Company**  
 Comparative Analysis of Changes in Surplus  
 As of 31 de diciembre de 2009

The following is a reconciliation of Unassigned Funds between that reported by the Company and as determined by the examination.

	<b>Examination Adjusted Increase</b>	<b>Decrease</b>	<b>BALANCE</b>
Unassigned Funds per Annual Statement			\$8,872,401
<b>ASSETS:</b>			
Bonds		\$4,724	
Real Estate		2,765,986	
Agents' balances in the Course Collection		1,487,676	
		\$4,258,386	
<b>Total</b>			(4,258,386)
Unassigned Funds per Examination			\$4,614,015

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### REAL ESTATE

- Real Estate reported as \$11,726,723 was reduced by \$2,765,986, as the Company did not obtain prior approval from the Commissioner to capitalize the home office real estate investment.

### AGENTS BALANCE IN COURSE OF COLLECTION

- Agents' balance in the course of collection reported as \$13,233,664, was reduced by \$1,487,676, which represented premiums receivable over 90 days old. The Company failed to comply with SSAP No. 4 of the NAIC Accounting Practices and Procedures Manual, which only permits receivables less than 90 days old as admitted assets.

### AGGREGATE WRITE-INS LIABILITIES

- The Company failed to report a subsequent event<sup>1</sup>. Aggregate write-ins for liabilities does not reported \$2,540,000, corresponding to the settlement of a legal claim agreed by the parties on March 19, 2010, prior to the issuance of the financial statements.

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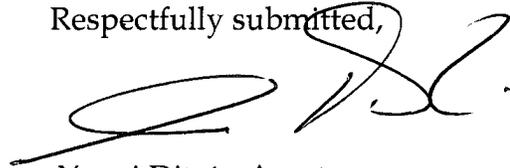
<sup>1</sup> In accordance with the provisions of SSAP No. 9 of the NAIC Accounting Practices and Procedures Manual, this statement provides for significant subsequent events to be recorded in the financial statements prior to their issuance.

**CONCLUSION**

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of National Life Insurance Company as of December 31, 2009, consistent with the insurance laws of Puerto Rico.

Per examination finding, the Company Unassigned Funds was \$4,614,015 in compliance with Insurance Code of Puerto Rico. In addition to the undersigned, Mrs. Yajaira Torres Martínez, Assistant Examiner, who participated in the examination.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Yoani Ditrén Acosta', written over the typed name below.

Yoani Ditrén Acosta  
Examiner