

COMMONWEALTH OF PUERTO RICO
OFFICE OF THE COMMISSIONER OF INSURANCE



U.S. COMMONWEALTH LIFE, A.I.
COMPLIANCE EXAM REPORT
AS OF NOVEMBER 30, 2014

CASE NO. EX-2014-39

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Commonwealth of Puerto Rico
OFFICE OF THE COMMISSIONER OF INSURANCE

December 7, 2015

Ms. Ángela Weyne Roig
Commissioner of Insurance
Office of the Commissioner of Insurance of Puerto Rico
B5 Tabonuco Street - Suite 216
PMB 356
Guaynabo, PR 00968-3029

Dear Commissioner:

In compliance with your instructions and pursuant to the Exam Order EX-2014-39 dated December 22, 2014, and the Puerto Rico Insurance Laws and Regulations, a compliance limited scope examination was made of the records of

U.S. Commonwealth Life, A.I.
Ponce De León Avenue #304
Suite 1000
San Juan, Puerto Rico 00918

hereinafter referred to as "the Insurer".

Scope of Examination

The current examination was conducted at the office of the Insurer's principal representative in Puerto Rico located at #304 Ponce de León Avenue Suite 1000 in San Juan, Puerto Rico. This limited scope compliance examination covered the period of April 1, 2009 through November 30, 2014.

The purpose of this examination is to evaluate the compliance of the Insurer with the Business Plan submitted to the Office of the Commissioner of Insurance of Puerto Rico, hereinafter referred to as "this Office", the Anti-Money Laundering Program submitted as well, and understand the underwriting process of the Insurer. The Insurer is subject to the provisions of Chapter 61 of the Insurance Code of Puerto Rico and Rules 80, 81, and 82 of the referred Code, as applicable.

History

The Insurer was organized under the laws and provisions of the Insurance Code of the Commonwealth of Puerto Rico and registered in the Department of State on March 13, 2009 with the registration number 485. The Insurer operates as an international insurer under the provisions of Law 399, "International Insurers and Reinsurers Act", and was authorized by this Office to start operations as an International Insurer Class 5 insurer effective April 1st, 2009, to transact disability insurance, life insurance and reinsurance thereof. The Certificate of Authority was amended on July 1st, 2009, to change the address previously notified, #802 Fernández Juncos Ave., Esq. La Paz, Miramar, which was the address of the legal representative, to its current one and the one where the business is held. Its Board of Directors designated Colin K. Murdoch-Muirhead and Ralph J. Rexach as representatives of the Insurer on March 2009. The Insurer named as Principal Representative, in March 2009, AON Insurance Managers (Puerto Rico).

The Insurer is sister company to Lighthouse Capital Insurance (LCI), based in The Cayman Islands. The Insurer was created in order to provide insurance based

solutions for wealthy private individuals and families, mainly of LCI, on a global basis to both US and non-US clients. All the policies issued are Private Placement Policies. The majority of the business held by the Insurer corresponds to policies that were previously issued by its sister company, and were somehow related to the United States. Policyholders of the Insurer include US citizens that want to invest abroad and non US citizens that are considering moving permanently to the US, among others. The Insurer maintained about 78 active policies as of the examination date.

Management and Control

The Insurer was 76% owned by Colin K. Murdoch-Muirhead and 24% owned by James A. Walker, Jr. when authorized by this Office. Later, in 2010, there was a change in control, approved by this Office with letter C-185, dated November 24, 2010, in compliance with Article 29.200¹ of the Insurance Code of Puerto Rico. After the change in control, the Insurer's structure was as follows:

Shareholders	% Ownership
Colin K. Murdoch-Muirhead	51
James A. Walker, Jr.	24
Paul Backhouse	12.5
Nicholas Ferris	12.5

¹ Applicable per Article 61.190 of the Insurance Code of Puerto Rico

The Insurer's Bylaws state, in its Article V, that the Board of Directors will consist of three (3) Directors initially and may be increased to no more than seven (7) members.

As of the examination date, the Directors of the Insurer, were as follows:

Directors
Colin Murdoch-Muirhead
Paul Backhouse
Raymond Burgos
Nicholas Ferris
Adrian Lynch

The Bylaws state, in its Article VI that the Board shall elect a President (also referred to as Chief Executive Officer), Treasurer (also referred to as Chief Financial Officer) and Secretary of the Corporation. The Board may elect or appoint, from time to time, one or more Vice-Presidents or additional Officers. As of November 30, 2014, the Officers of the Insurer were as follows:

Officers	Position
Colin Murdoch-Muirhead	President
Raymond Burgos	Treasurer / Secretary
Hugo F. Cordova Ayuso	Assistant Secretary

It's important to note that while AON Insurance Managers Puerto Rico (AON Puerto Rico) serves as the Licensed Insurance Manager and Registered Office of the Insurer, it's AON Insurance Managers Cayman Ltd. (AON Cayman) who provides the signatory, operational and audit controls for all policies, accounts and transactions.

Following is a list of AON employees that provide service to the Insurer, with their position and location:

<i>Employees</i>	<i>Position</i>	<i>Location</i>
Hugo Cordova	Account Manager / Senior Administrator	Puerto Rico
Raymond Burgos	Legal Counsel - In House	Puerto Rico
Katherine Arch	Account Manager	Cayman Islands
Candice Merren	Accountant	Cayman Islands
Elizabeth Miller	Accountant	Cayman Islands
Elfreda Ebanks	Account Executive	Cayman Islands
Jordan Belfour	Account Executive	Cayman Islands
Adrian Lynch	Managing Director	Cayman Islands

Business Plan

During the process of authorization the Insurer presented its Business Plan for becoming a Class 5 International Insurer. This plan contained the details on how they were going to operate, the factors that led to choose Puerto Rico, the benefits to the customers, how their policies were going to work and their expectations on clients and growth, etc. Now the Insurer maintains a Business Plan that is updated biannually or annually, as necessary, in order to take into consideration the current market conditions and changes.

We obtained the Annual Business Plan 2014 and took it into consideration while performing our examination procedures. The plan is divided in subtopics; in the following paragraphs, the most significant ones, are discussed.

Clients

The Insurer targets to high wealth US clients, international US pre-immigration, international with US beneficiaries and international with no US connection, that are represented by an independent party (professional law firms, accounting, financial planners, insurance brokers, etc.) who is the one contacting the Insurer in order to enter into business with them. Their net worth should be \$1,000,000 or have an individual income of \$200,000 during the past two years. Also, their investment assets should be of at least \$5,000,000. However, through our procedures we noted and discussed with the Insurer's personnel, that sometimes the Insurer makes exceptions to the minimum of investment assets required if he understands that this client can bring other potential clients that will meet the requirement.

Products

The Insurer provides customized policies to its clients in order to meet their specifications based on their insurance and / or investment goals. These policies are in general, flexible premium life insurance policies or flexible premium variable annuity policies. For these, the Insurer has different products available for which we obtained the policy form as an example for our review. The products include:

- Deferred variable annuity and single premium immediate variable annuity
- Full cash value variable life policy
- Restricted cash value policy
- Global variable life full cash value
- Global no cash value death benefit only policy

The Business Plan includes a summary of charges for standard policies. However, it is important to recall that each policy issued is different because they are customized to the client's needs. The Business Plan includes as well, an overview of the different policies.

Reinsurers

The Insurer bears insurance risk in the amount of \$1,000 for each policy, but this amount could be increased in the future, if necessary. The policies are either 100% reserved at all times or are 100% reinsured. It's important to note that all policies issued are reinsured at the client's expense. The Insurer's principal reinsurer is Hannover Life Reinsurance Company of America. However, as an alternative to them or when they can't provide 100% of the reinsurance, the Insurer obtains reinsurance from alternative sources, including private reinsurance pools and/or third party reinsurers. The premium will depend on the results of the medical examinations.

AON (Puerto Rico)

Management and administration services are provided by AON Cayman. Since they offered these services to the Insurer's sister company, LCI, they were also contracted for the Insurer. Both the Insurer and AON developed an Operations Manual that describes in detail how all procedures should be performed. This Manual is reviewed and updated constantly and as necessary, and is part of the guidance that AON Puerto Rico uses for its duties as the Principal Representative and in working together with AON Cayman. It's AON Cayman who performs all due diligence on clients and financial counterparties (verification of prospective clients and source of

funds). Once AON Cayman signs off, then the policy is issued. During our procedures we were able to confirm that evaluations on prospective clients, funds, etc. are performed on AON Cayman. Once procedures abroad are performed and approved, they send AON Puerto Rico a Compliance Checklist with the appropriate sign offs of verification and approval. AON Puerto Rico archive the documentation provided by AON Cayman on the client file maintained in Puerto Rico, opens the Separate Account and continues with the subscription process.

Other

The Insurer's external auditor is RSM ROC & Company, a Puerto Rico accounting firm. For actuarial services, the Insurer utilizes Ernst & Young in Hartford, Connecticut. All international insurance and reinsurance matters, policy design and negotiations of the Insurer are handled by Middlebury Investments Inc. and J.A. Walker & Associates, which are owned by the two major shareholders of the Insurer. Operations of the Insurer are under the control and direction of its Board of Directors.

Underwriting Process

As mentioned previously, the Insurer obtains its clients from referrals of professional firms. An *Illustration* document is provided to the prospective client, which presents the options available offered by the Insurer with projections so he can evaluate if the Insurer meets its needs. The prospective client, then, has to fill out an Underwriting Questionnaire in order for the Insurer to evaluate if it's a viable business and proceed further on with its underwriting process. Once this is corroborated, the prospective client fills out an application that contains, among other things, information

regarding source of funds, beneficiaries, investment goals and investment managers desired. This last information is important because the Insurer does not work with the management of investments. The Insurer limits itself to investigate and approve the use of that investment manager. The clients set their investment goals and those are communicated to the investment manager. Therefore, all the investment risk is retained by the client. The Insurer does not guarantee any minimum value on the separate account.

Once the application is completely filled out, the Insurer begins its investigation phase, or "know your client" due diligence phase, which takes place in AON Cayman. The Insurer looks into the referral, the policy owner, the proposed life insureds, the source of funds, the investment manager, and all other parties related in any way to the proposed policy. AON Cayman utilizes Bridger Insight XG to perform part of its investigation. This software allows to search if a person is on OFAC² watch lists, but also includes in its database over 20 other watch lists.

When all investigations conclude, and the results are favorable, AON Cayman sends to AON Puerto Rico the *New Client Acceptance Checklist*. This checklist contains an Approval section with the electronic signatures that approve the prospective client. The Insurer then opens up the Separate Account in Scotiabank that will be managed by the investment manager selected and approved.

² Office of Foreign Assets Control

As stated in Section 11.02(c) of the Insurer's Bylaws, all such separated accounts shall be established and maintained under the signatory control of the Insurer and its duly appointed directors, officers and representatives. Following is the list of the Insurer's nine (9) signatories, by category.

Authorized Signatures	Category
Colin Murdoch-Muirhead	A
Paul Backhouse	A
Nicholas Ferris	A
Adrian Lynch	A
Candice Merren	B
Colleen Artuch	B
Janet Sairsingh	B
Dannel Rahamut	B
Ghislain Ghyoot	B

For example, for the approval of banking transactions for accounts with amounts over \$200,000, two (2) B and one (1) A signatures are required. If the banking transaction consists of a Letter of Authorization, two (2) A signatures are needed. For other services, like account transfer requests, closing requests, drafts requests, etc., two (2) B signatures [Authorized Representatives of AON Cayman] will execute the forms and documents.

We selected a sample of policies to review the file and observed the different checklists completed. During our review we noted that it was common to find several policies in the same file. The reason for this is that the file is kept for a family group. In

the majority of the cases, funds were held in a trust fund belonging to the family. In addition we noted that the sample selected consisted all of policies transferred from LCI and therefore, not all checklists required by the insurer were filed because those were not in place for the period of issuance and/or for LCI. However, the Insurer was able to provide us with the recreated compliance checklist for each of the cases. The checklists are completed in the parts for which information from LCI was available from the original issuance. Also, we were provided with some of the reports from Bridger Insight XG that were able to generate in the software with the information available.

Since our sample selected randomly included only policies that were transferred from LCI, we selected, judgmentally, another file from a policy that was issued by the Insurer, not transferred. Regarding this file we noted that the Insurer kept a well-organized file including all questionnaires, application, recommendation letters, etc. supporting a proper investigation and issuance of policy. Verification of Anti Money Laundering procedures and other investigations is documented in the New Client Acceptance Checklist, signed electronically by AON Cayman, and explained further in the next topic.

After procedures performed and evidence reviewed, we can conclude that the Insurer complied with its underwriting procedures by completing the necessary forms (questionnaires, applications, etc.) and investigating further the proceeds of funds and persons associated to the policy. It is our opinion that the Insurer has appropriate practices in place in order to select new clients and issue responsibly, policies to wealthy private international individuals and families.

Anti-Money Laundering Program

In order to avoid being used as an instrument for money laundering, the Insurer has a program for Anti-Money Laundering (AML) which consists, generally, on knowing their customers and investors, monitoring, recognizing and reporting suspicious transactions.

The program and procedures include various checklists³ to be completed by the prospective customers and by the Insurer. All information obtained during this process, as well as other information obtained, is documented in a Client Acceptance Checklist, which is described as part of the Insurer's Compliance Manual. Procedures performed, including all checklists completed, are maintained in the files at AON Cayman, since they are performed abroad. Once the prospective customer has been verified and accepted, AON Cayman sends AON Puerto Rico copy of the Client Acceptance Checklist Sing Off, as evidence of procedures performed on AML.

The Insurer's AML program has been in place for all new policies issued since its authorization. However, for those policies that were transferred from its sister company, the program was not in place as evaluated for this exam, and therefore, compliance with the program for those policies was not evaluated. From a sample of files pertaining to new policies issued by the Insurer, we were able to review the Client Acceptance Checklist and noted the clients were evaluated for AML and the checklist was properly signed off.

³ Personal Declaration; Verification Checklist for Individuals or Verification Checklist for Companies; and Internal Report Form.

All employees of the Insurer are to receive annual training on the current program. Also, they certify each year to have read, understand and agreed to implement the program. Since these procedures are performed by AON Cayman, by their employees assigned to the Insurer, the trainings and compliance procedures are also performed at AON level. The program also states the Insurer's program will be subject to an annual independent audit in connection with the Insurer's annual independent audit of its financial statements.

Per our review we learned that the Insurer held annual trainings for the years 2009 and 2011-2014. In these trainings, an average of 43% of employees and 54% of the authorized signatories participated. Training sessions were held on AON Insurance Managers Cayman Ltd, which explains why two of the employees of the Insurer (25%), which are based in Puerto Rico, were not present. We obtained copies of the handouts for all these trainings and confirmed the information presented pertaining to AML. Aside from the trainings, employees of the Insurer are handed the *USCL Compliance Manual and Policy Administration and Operational Procedures* which includes detailed information on procedures to be performed regarding AML.

Throughout our exam, we requested copy of the audits performed on the program but these were not provided. We reviewed the financial statements audit reports, prepared by RSM ROC & Company CPA & Consultants, and submitted to this Office, for the period under examination and noted it did not include any reference to the AML Program.

For those cases in which employees have identified warning signs of suspicious transactions, they notify it to the Reporting Officer⁴, whose decision to report to the Government is reviewed by another Director or Officer of the Insurer. For the period under examination no warning signs of, or suspicious activities have been identified or reported.

After our review on the Insurer's AML Program and Procedures we can conclude that the Insurer is complying with its Program in terms of verification of prospective clients. Being this is a procedure performed in Cayman Islands, we weren't able to verify all the documentation kept for prospective client evaluations.

However, even though not all employees have participated in the annual trainings of AML, we do believe the Insurer takes the appropriate measures to maintain its employees up to date with the knowledge necessary to apply the company's AML policies and procedures and be aware of the warning signs of suspicious transactions. Per our examination review, the Insurer is not in compliance with its own program in not having an independent audit performed to evaluate the AML Program.

Cordially,



Carla Colón León, CPA
Exams Supervisor

⁴ President and CEO of the Insurer.

Summary of Non-Compliance Findings

AML Program - Pages 11-14

1. No AML training was held for 2010 as required by the AML Program.
2. An average of 43% of employees and 54% of authorized signatories participated in the annual trainings held.
3. No annual independent audit for the program was held in connection with the Insurer's annual independent financial statement audits.

Recommendations:

1. The Insurer must perform at least annually an AML Training and make it available as a webinar or a live-web-based for those employees not physically present in the AON Cayman facilities.
2. Include as part of the financial statement audits, the annual audit of the AML Program.