STATE OF NEW YORK INSURANCE DEPARTMENT

REPORT ON EXAMINATION

OF THE

METROPOLITAN LIFE INSURANCE COMPANY

CONDITION: DECEMBER 31, 2003

DATE OF REPORT: OCTOBER 6, 2005

STATE OF NEW YORK INSURANCE DEPARTMENT

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METROPOLITAN LIFE INSURANCE COMPANY

AS OF

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| DATE OF REPORT: | OCTOBER 6, 2005 |
| EXAMINER: | MARK MCLEOD |

REPORT ON ASSOCIATION EXAMINATION

OF THE

METROPOLITAN LIFE INSURANCE COMPANY

AS OF

DECEMBER 31, 2003

BY

THE INSURANCE DEPARTMENTS

OF THE

STATE OF NEW YORK

STATE OF MISSISSIPPI

STATE OF NEVADA

DATE OF REPORT: OCTOBER 6, 2005

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STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

George E. Pataki
Governor

Howard Mills
Superintendent

October 6, 2005

Honorable Howard Mills
Superintendent of Insurance
Albany, New York 12257

Sir:

In accordance with instructions contained in Appointment No. 22129, dated January 15, 2004 and annexed hereto, an examination has been made into the condition and affairs of Metropolitan Life Insurance Company, hereinafter referred to as “the Company,” at its home office located at 200 Park Avenue, New York, New York 10166-0188.

Wherever “Department” appears in this report, it refers to the State of New York Insurance Department.

The report indicating the results of this examination is respectfully submitted.

STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

George E. Pataki
Governor

Howard Mills
Superintendent

October 6, 2005

Honorable Howard Mills
Superintendent of Insurance
State of New York

Honorable John Morrison
Chairman, Western Zone
Commissioner of Insurance and Securities
State of Montana

Honorable John Oxendine
Chairman, Southeastern Zone
Commissioner of Insurance
State of Georgia

Sirs:

An examination has been made into the condition and affairs of Metropolitan Life Insurance Company, hereinafter referred to as "the Company," at its home office located at 200 Park Avenue, New York, New York 10166-0188.

The examination was conducted by the New York State Insurance Department, hereinafter referred to as the "the Department," with participation from the State of Mississippi representing the Southeastern Zone and the State of Nevada representing the Western Zone.

The report on examination is respectfully submitted.

# 1. EXECUTIVE SUMMARY

## General

This was a limited scope examination of the Company as of December 31, 2003 that included: 1) a review or audit of certain targeted balance sheet items and 2) a review or audit of certain market conduct activities of the Company. (See Section 2 of this report)

On November 29, 1998, the Company announced that it would pursue converting to a stock company from a mutual company through demutualization under Section 7312 of the New York Insurance Law. On February 18, 2000, the Company's policyholders approved the plan to convert to a stock company. The Company's demutualization was approved by the Superintendent on April 7, 2000. (See Section 3A of this report)

In 2000, the Company completed its acquisition of GenAmerica Corporation, which is the parent company of General American Life Insurance Company. (See Section 3A of this report)

On January 31, 2005, MetLife, Inc. entered into an agreement to acquire Citigroup's Travelers Life & Annuity business ("Travelers"), and substantially all of Citigroup's international insurance businesses except its business in Mexico, for $11.5 billion. (See Section 3A of this report)

## Reserves

The Department conducted a review of reserves as of December 31, 2003. The Company addressed Department concerns about reinvestment risks for the Company's Structured Settlement and Single Premium Immediate Annuity business, due to the prevailing low interest rate environment, by strengthening related reserves by the amount of $600 million as of December 31, 2004. Department concerns were also raised with respect to certain reinsurance agreements for secondary guarantees on universal life insurance. The net effect is disallowance of reserve credit in the amount of $13 million as of December 31, 2003, and in the amount of $43 million as of December 31, 2004. The Company has also agreed to address concerns regarding the classification of certain guaranteed interest contracts ("GICs") by revising their methodology consistent with the Department's position, which considers the Company's management practices, for calculating such reserves commencing with the December 31, 2005 reserve valuation. Finally, the Company has agreed to refine the Long Term Care ("LTC") reserve analysis and to strengthen such reserves by $450 million during 2005. (See Section 5D of this report)

Internal Controls

The examiner recommends that the Company develop and implement a plan to improve the Company's system of internal controls in the areas of financial reporting and recordkeeping, information systems, and market conduct (regulatory compliance). (See Section 7 of this report)

With respect to the Company's loaned securities program during the examination period, the Company failed to maintain daily Broker Collateralization Reports, documented collateral requests to undercollateralized brokers, and documented explanations of collateral price overrides. The Company needs to strengthen its controls over its loaned securities program as well as improve its reporting of such. (See Section 7 of this report)

The examiner recommends that the Company correctly designate its leased securities on Schedule D of its filed annual statement. (See Section 7 of this report)

The Company did not provide adequate evidence that it performed timely cash reconciliations during the examination period. The examiner recommends that the Company maintain documentation sufficient to evidence that it performs periodic cash reconciliations in a timely manner between the general ledger balance and the bank balance for its bank accounts and that such reconciliations include adequate supporting detail. (See Section 7 of this report)

The Company could not reconcile the differences between balances that comprised the Real Estate Managing Agents' amounts reported in Schedule E – Part 1 of the 2003 filed annual statement and the bank confirmations received by the examiner. The examiner recommends that the Company perform timely periodic reconciliations with adequate supporting detail between the Real Estate Managing Agents' accounts listed in Schedule E – Part 1 and the bank balance for its real estate bank accounts and maintain documentation of such reconciliations. (See Section 7 of this report)

The Company misrepresented their certification of compliance with the SVO filing requirements for securities reported with a "Z" designation. The examiner recommends that the Company comply with the SVO filing requirements in the future with respect to the rating of securities. (See Section 7 of this report)

The examiner recommends that the Company provide a complete listing of custodians in response to future annual statement General Interrogatory questions regarding such, as well as in response to future examination requests. (See Section 7 of this report)

The Company violated Section 1505(d)(2) of the New York Insurance Law by failing to file six reinsurance treaties with the Superintendent at least 30 days prior to entering into such reinsurance treaties with its affiliates. (See Section 3B of this report)

Market Conduct

The Company violated numerous sections of Department Regulation No. 60 regarding the replacement of life insurance policies and annuity contracts. The Company also violated Section 243.2(b) of Department Regulation No. 152 for failing to maintain documents for its annuity replacements. Further, the Company violated Section 51.6(e) of Department Regulation No. 60 for failing to follow its filed replacement procedures and failing to furnish changes to its replacement procedures within 30 days of such changes to the Superintendent. (See Section 6A of this report)

Based on the examiner's review, the life and annuity replacement inventories provided by the Company were significantly understated. In addition, the examiner was unable to determine if the Company was in compliance with Department Regulation No. 60 during the examination period with respect to annuity replacements since the Company destroyed certain replacement records in accordance with its established retention schedule and in violation of Department regulations. (See Section 6A of this report)

The Company violated Section 3203(a)(16) of the New York Insurance Law by issuing life insurance policies subject to Section 4232(b) of the New York Insurance Law without disclosing that additional amounts are not guaranteed and that the insurer has the right to change the amount of interest credited to the policy and the cost of insurance or other expense charges deducted under the policy which may require more premium to be paid than was illustrated or the cash values may be less than those illustrated. The Company also violated Section 3203(a)(15) of the New York Insurance Law by issuing participating cash value policies without disclosing that dividends are not guaranteed and that the insurer has the right to change the amount of dividend to be credited to the policy which may result in lower dividend cash values than were illustrated, or, if applicable, require more premiums to be paid than were illustrated. The Company's actions or lack of action described above are an indication that the Company negligently failed to comply with Section 3203 of the New York Insurance Law. There were 129,934 policies affected by the violation of 3203(a)(15) of the New York Insurance Law and 10,434 policies affected by the violation of 3203(a)(16) of the New York Insurance Law. The Company sent endorsements to all policyholders affected by these violations during the period February 2 through February 4, 2004, to correct the absence of the policy provisions required by Sections 3203(a)(15) and 3203(a)(16) of the New York Insurance Law. (See Section 6C of this report)

The Company violated Section 3209(b)(1) of the New York Insurance Law and/or Section 53-3.5(a) of Department Regulation No. 74 by failing to provide the applicant with the preliminary information or an illustration, as applicable, prior to or at the time of application for universal life and variable universal life policies. (See Section 6A of this report)

The examiner recommends that the Company review its policy files and identify all such cases where: 1) there is no signed statement by the applicant indicating receipt of the preliminary information or an illustration, as applicable; 2) the signed statement that the applicant received the preliminary information or illustration, as applicable, indicates it was provided after the policy was delivered; and 3) the signed statement that the applicant received the preliminary information or illustration, as applicable, indicates it was provided after the date of the application but prior to or at the time that the policy was delivered. The examiner also recommends that the Company develop and propose a plan of remediation acceptable to the Department which addresses the Company’s failure to provide the required disclosure material (i.e., preliminary information or an illustration, as applicable) in a timely manner. (See Section 6A of this report)

The examiner further recommends that the Company provide to the Department a plan to assure that, in the future, applicants are provided with the required disclosure in a timely manner in compliance with Section 3209 of the New York Insurance Law and Department Regulation No. 74. (See Section 6A of this report)

The Department is very concerned with the Company’s failure to provide important consumer disclosures as required by statute and regulation. The need for disclosure in participating cash value life insurance policies and life insurance policies subject to Section 4232 (b) of the New York Insurance Law was the Legislature’s response to the “vanishing premium” issues which had occurred in the sale of these types of policies. The failure of the Company to comply with these statutory requirements even after it was brought to its attention only serves to heighten the Department’s concerns. In addition, Section 3209 of the New York Insurance Law and Department Regulation No. 74 require that the consumer be provided a copy of a preliminary information statement or in lieu of such statement a sales illustration which complies with Department Regulation No. 74 at or prior to the time of application. The failure to provide the consumer with a copy of the preliminary information statement or in the alternative a sales illustration until the time of policy delivery is again contrary to statutory and regulatory requirements. Section 3209 , Sections 3203 (a)(15), (16) and (17) of the New York Insurance Law and Department Regulation No. 74 establish the framework for providing basic and timely disclosure to consumers with respect to life insurance products. The timely disclosure of this information is essential in order for the consumer to make an informed decision. (See Section 6C of this report)

The Company violated Section 3201(b)(1) of the New York Insurance Law by using three “employee enrollment/consent to insurance” forms, for its COLI group policies, that were not filed with and approved by the Superintendent. (See Section 6B of this report)

The Company violated Section 54.7(b)(4) of Department Regulation No. 77 by having maximum cost of insurance rates stated in its juvenile and small face amount variable universal life policies in excess of those permitted. The examiner recommends that the Company provide endorsements for all juvenile and small face amount policies where the maximum cost of insurance rates stated in the policies are in excess of those permitted by Department Regulation No. 77, for the purpose of reducing such maximum cost of insurance rates to the rates permitted by Department Regulation No. 77. The examiner also recommends that the Company review its small face amount and juvenile policies to determine which policies were charged more than the maximum mortality rates permitted by Department Regulation No. 77 and the amount of the excess, and report the results of the review to the Department, and in addition, provide the Department with the historic experience (deaths and exposures) and the history of cost of insurance rates charges for small face amount, juvenile, and smoker classes. (See Section 6B of this report)

Transparency in Financial Reporting

Project Metronome has enabled the Company to invest in new offerings of Eurobonds from which US entities are normally precluded. Since US entities are normally precluded by Regulation S, the examiner recommends that the Company consider obtaining a legal opinion from the Securities and Exchange Commission ("SEC") regarding the legality of the Project Metronome investment and related transactions. (See Section 9 of this report)

The examiner recommends that the Company record unrealized losses on the forward transfer agreements related to Project Metronome as an unrealized foreign exchange capital loss. (See Section 9 of this report)

The examiner recommends that the Company report the securities lending collateral liability as a separate write-in item clearly identified as such. (See Section 5A of this report)

Derivatives Operations

During a significant portion of the examination period, the Company's derivative unit, responsible for the execution and oversight of derivative transactions and activities, was considerably understaffed as highlighted in Department meetings with that unit's personnel. At one point during the examination period, the director of the unit was the only person overseeing these activities as well as performing the primary responsibilities in this area, including the trading of derivatives. Additionally, during this time, the derivative accounting team was insufficiently and unsuitably staffed, requiring significant planned and actual staff additions and firings, and resulting subsequent to the examination period in the dismissal of the head of derivative accounting. This inappropriate staffing of the back office, in particular, contributed to an environment that could, at times, detrimentally impact transactional timeliness and accuracy and the timely confirmation of transactions. The board of directors failed to review the derivative staff's expertise and was not aware of certain facets of the execution of this function, which resulted in deficiencies and reflected a lack of adequate controls. (See Section 8 of this report)

## 2. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 1998. This examination covers the period from January 1, 1999 through December 31, 2003. This was a limited scope examination which included: (1) a review or audit of certain targeted balance sheet items considered by this Department to require analysis, verification or description; (2) a review of certain market conduct activities of the Company; and (3) a review or audit of the items noted in the following paragraph. The balance sheet items targeted for review were bonds, mortgages, real estate, cash, policy loans, other invested assets, reinsurance and aggregate reserves for life contracts. The market conduct activities targeted for review were advertising and sales activities, underwriting and treatment of policyholders (e.g., claims, surrenders). As necessary, the examiner reviewed transactions occurring subsequent to December 31, 2003 but prior to the date of this report (i.e., the completion date of the examination).

The examiner utilized the National Association of Insurance Commissioners' Examiners Handbook or such other examination procedures, as deemed appropriate, in such review and in the review or audit of the following matters:

Company history
Management and control
Corporate records
Fidelity bond and other insurance
Territory and plan of operation
Market conduct activities
Growth of Company
Business in force by states
Reinsurance
Accounts and records
Financial statements

The examiner reviewed the corrective actions taken by the Company with respect to the violation contained in the prior report on examination. The results of the examiner's review are contained in item 9 of this report. This report on examination is confined to financial statements and comments on those matters which involve departure from laws, regulations or rules, or which require explanation or description.

## 3. DESCRIPTION OF COMPANY

### A. History

The Company was incorporated as a stock life insurance company under the laws of the State of New York on March 24, 1868 (in succession to National Travelers Insurance Company, incorporated May 1866), and commenced business on March 25, 1868. In 1915, the Company converted from a stock company to a mutual company, a company operated for the benefit of its policyholders. The Company converted back to a stock company on April 7, 2000, and became a wholly-owned subsidiary of MetLife, Inc.

In 2000, the Company completed its acquisition of GenAmerica Financial Corporation, which is the parent company of General American Life Insurance Company. Other companies acquired include Reinsurance Group of America, Incorporated, Cova Corporation, Equity Intermediary Company, Paragon Life Insurance Company, and Missouri Reinsurance (Barbados), Inc.

On February 13, 2001, the Federal Reserve Board approved the Company's application to acquire Grand Bank N.A. of Kingston, New Jersey. The Federal Reserve Board also approved the Company's request for financial holding company status. On February 28, 2001, MetLife, Inc., purchased Grand Bank N.A. and re-named it MetLife Bank N.A. MetLife Bank offers interest bearing FDIC insured accounts, including checking and money market accounts and certificates of deposit.

On November 29, 1998, the Company announced that it would pursue conversion to a stock company from a mutual company through demutualization under Section 7312 of the New York Insurance Law. On February 18, 2000, the Company's policyholders approved the plan to convert to a stock company. The demutualization plan was approved by the Superintendent and the Company demutualized on April 7, 2000.

When the Company converted to a stock company on April 7, 2000, it became a wholly-owned subsidiary of MetLife, Inc., a Delaware holding company. Each policyholder's ownership interest in the Company was extinguished and each eligible policyholder received, in exchange for that interest, trust interests representing shares of common stock of MetLife, Inc. held in the MetLife Policyholder Trust, cash, or an adjustment to their policy values in the form of policy credits, as provided in the reorganization plan. On the date of demutualization

MetLife, Inc. conducted an initial public offering of 202,000,000 shares of its common stock and a concurrent private placement of an aggregate of 60,000,000 shares of its common stock at an offering price of $14.25 per share. The shares of common stock issued in the offerings were in addition to 494,466,664 shares of MetLife, Inc. common stock distributed to the MetLife Policyholder Trust for the benefit of the policyholders of the Company in connection with the demutualization. On April 10, 2000, MetLife, Inc. issued 30,300,000 additional shares of its common stock as a result of the exercise of over-allotment options granted to underwriters in the initial public offering.

MetLife, Inc. and MetLife Capital Trust I, a Delaware statutory business trust wholly-owned by MetLife, Inc., issued 20,125,000 8.00% equity security units on April 7, 2000 for an aggregate offering price of $1.006 billion. Each unit consists of a contract to purchase shares of common stock and a capital security of MetLife Capital Trust I. The proceeds of this offering were combined with the proceeds of the other securities offerings described above and used to pay for costs incurred in the demutualization process, including payments made to policyholders and fees and expenses.

On the date of demutualization, April 7, 2000, the Company established a closed block for the benefit of individual participating policyholders who are expected to receive ongoing dividend payments as part of their policies. The Company designated assets to the closed block in an amount that it reasonably expected would , together with revenue from the policies in the closed block, be sufficient to pay benefits and certain taxes and expenses of the closed block, and provide for the continuation of the then current dividend scales, if the experience underlying such dividend scales continued and for appropriate changes in such scales if the experience changed. These cash flows are expected to be sufficient to pay each policyholder, including the last surviving individual, a commensurate amount of cash flow for policyholder benefits and dividends.

On June 27, 2000, MetLife, Inc.’s board of directors authorized the repurchase of up to $1 billion of MetLife, Inc.’s outstanding common stock. After the completion of this repurchase program, MetLife, Inc.’s board of directors authorized another $1 billion common stock repurchase program on March 27, 2001. Both authorizations allowed MetLife, Inc. to purchase common stock from the Metropolitan Life Policyholder Trust, in the open market, and in private transactions.

After the demutualization, the Company streamlined its corporate structure in 2002 and 2003. The overall objective that triggered the 2002 and 2003 restructuring efforts was to simplify and flatten the corporate structure by moving up to MetLife, Inc. operating companies held by the Company. The restructuring efforts in 2002 and 2003 were accomplished via cash purchases of Company subsidiaries at fair market value. As a result, the Company replaced investments in subsidiaries with cash or securities.

On January 1, 2003, MetLife, Inc. established a new direct subsidiary, MetLife Group, Inc., as an employee services company to provide personnel to support all activities of the MetLife enterprise. With certain limited exceptions, all United States associates formerly employed by the Company became employees of MetLife Group, Inc. For regulatory purposes, certain employees who adjudicate insurance claims remained employees of the Company. In addition, certain sales force and agency administrative support personnel remained employees of the Company.

In November 1993, February 1994 and November 1995, the Company issued $1.55 billion of 10, 20 or 30 year surplus notes at interest rates between 6.3% and 7.875%. Each payment of interest and/or principal on the notes may be made only with the prior approval of the Superintendent under the provisions of Section 1307 of the New York Insurance Law. On November 3, 2003, a 6.3% $400 million surplus note matured and a 7.45% $300 million surplus note was redeemed. A premium of $11 million was paid for the early redemption of the $300 million note. In 2002, the Company issued two capital notes in the amounts of $100 million and $400 million at an interest rate of 7.129%. The notes will mature in 2032 and 2033.

In the third quarter of 2004, the Company entered into an agreement to sell its subsidiary, SSRM Holdings, Inc. ("SSRM") to Blackrock, Inc. On January 31, 2005, the sale was completed for $375 million. SSRM was a provider of a broad variety of asset management products and services to the Company, third-party institutions and individuals. SSRM conducts its operations through two wholly-owned subsidiaries: State Street Research & Management Company, a full-service investment management firm; and SSR Realty Advisors, Inc., a full-service real estate investment advisor. SSRM offers investment management services in all major investment disciplines through multiple channels of distribution in both the retail and institutional marketplaces.

On January 31, 2005, MetLife, Inc. entered into an agreement to acquire Citigroup's Travelers Life & Annuity business ("Travelers"), and substantially all of Citigroup's international insurance businesses except its business in Mexico, for $11.5 billion. In connection with the transaction, Citigroup and MetLife, Inc. have entered into ten year agreements under which MetLife, Inc. will expand its distribution by making products available through some Citigroup distribution channels, including Smith Barney, Citibank branches, and Primerica in the U.S., as well as a number of international distribution channels. The acquisition of Travelers was completed for a final acquisition price of $12.0 billion. Consideration paid by MetLife, Inc. consisted of approximately $10.9 billion in cash and 22,436,617 shares of the Company's common stock with a market value of approximately $1 billion. The cash portion of the purchase price was financed through the issuance of debt securities, common equity units, preferred shares, and cash on-hand. During June 2005, in connection with the acquisition of Travelers, MetLife, Inc. issued $2.0 billion senior debt, $2.07 billion common equity units and $2.1 billion preferred stock**.**

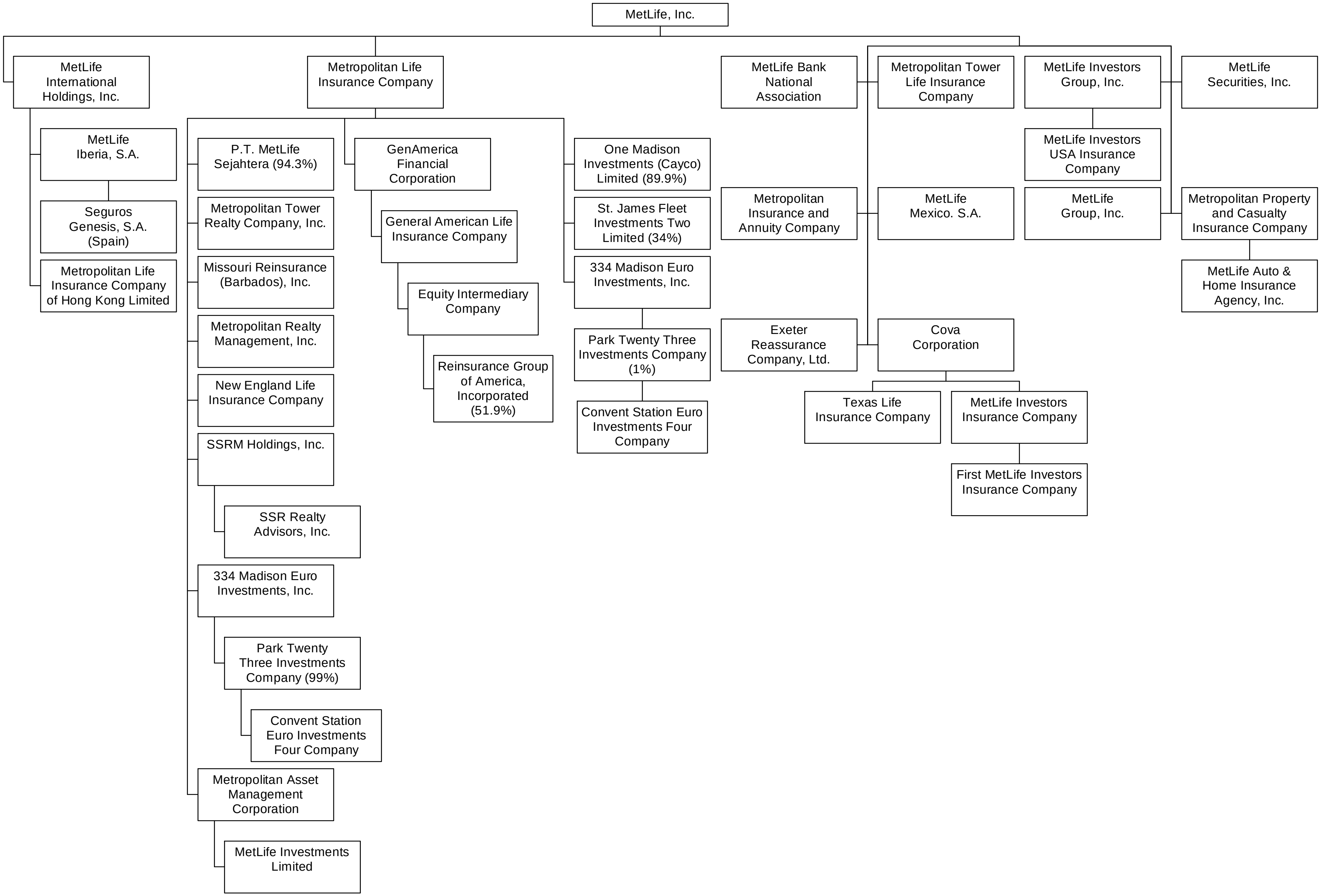
On May 4, 2005, MetLife, Inc. sold its 200 Park Avenue property above Grand Central Station in Manhattan for $1.72 billion. The book value of this property was $1.329 billion. According to the Company, the sale resulted in an after-tax realized capital gain of approximately $400 million.

In May 2005, the Company also sold its One Madison Avenue Building in Manhattan to SL Green Realty for $918 million. As of December 31, 2004, the book value of this property was $239.7 million. According to the Company, the sale resulted in an after-tax realized capital gain of approximately $417 million.

B. Holding Company

The Company is a wholly owned subsidiary of MetLife, Inc., a Delaware holding company.

An organization chart reflecting the relationship between the Company and significant entities in its holding company system as of December 31, 2003 follows:


MetLife, Inc.
MetLife International Holdings, Inc.
MetLife Iberia, S.A.
Seguros Genesis, S.A. (Spain)
Metropolitan Life Insurance Company of Hong Kong Limited
Metropolitan Life Insurance Company
P.T. MetLife Sejahtera (94.3%)
Metropolitan Tower Realty Company, Inc.
Missouri Reinsurance (Barbados), Inc.
Metropolitan Realty Management, Inc.
New England Life Insurance Company
SSRM Holdings, Inc.
SSR Realty Advisors, Inc.
334 Madison Euro Investments, Inc.
Park Twenty Three Investments Company (99%)
Convent Station Euro Investments Four Company
Metropolitan Asset Management Corporation
MetLife Investments Limited
GenAmerica Financial Corporation
General American Life Insurance Company
Equity Intermediary Company
Reinsurance Group of America, Incorporated (51.9%)
One Madison Investments (Cayco) Limited (89.9%)
St. James Fleet Investments Two Limited (34%)
334 Madison Euro Investments, Inc.
Park Twenty Three Investments Company (1%)
Convent Station Euro Investments Four Company
MetLife Bank National Association
Metropolitan Insurance and Annuity Company
Exeter Reassurance Company, Ltd.
Metropolitan Tower Life Insurance Company
MetLife Mexico. S.A.
Cova Corporation
Texas Life Insurance Company
MetLife Investors Insurance Company
First MetLife Investors Insurance Company
MetLife Investors Group, Inc.
MetLife Investors USA Insurance Company
MetLife Group, Inc.
MetLife Securities, Inc.
Metropolitan Property and Casualty Insurance Company
MetLife Auto & Home Insurance Agency, Inc.

The Company had 23 service agreements in effect with affiliates during the examination period.

| Type of Agreement | Effective Date | Provider(s) of Service(s) | Recipient(s) of Service(s) | Specific Service(s) Covered | Income/ (Expense)* For Each Year of the Examination |
|---|---|---|---|---|---|
| 1. Service Agreement | January 1, 1978 | Primarily, the Company incidentally, various Company subsidiaries | Primarily, various Company subsidiaries; incidentally, the Company | Certain services, property, facilities and equipment, including but not limited to: accounting, tax and auditing services; legal services; actuarial services; employee benefit plans and personnel administration; sales services; software development services; electronic data processing operations; communications operations and investment services; electronic data processing equipment; business property; communications equipment and security vault; as each party may, from time to time, request. | 1999 - $121,929,094<br>2000 - $252,464,174<br>2001 - $418,984,931<br>2002 - $293,141,157<br>2003 - $ 84,148,108 |
| 2. Service Agreement | January 1, 1980 | the Company | 2154 Trading Corporation ("2154"). 2154 was dissolved in April 1999. | Such services and facilities as 2154 may determine to be reasonably necessary including but not limited to the following: appraisals; negotiation; architectural services; documentation; general property administration; and accounting services. | 1999 - $6,273 |
| 3. Service Agreement | January 1, 1981 | the Company | Metropolitan Realty Management, Inc. ("MRM") | Such services and facilities as MRM may determine to be reasonably necessary including but not limited to the following: appraisals; negotiation; architectural services; documentation; general property administration; and accounting services. | 1999 - $0<br>2000 - $0<br>2001 - $0<br>2002 - $0<br>2003 - $0 |

| Type of Agreement | Effective Date | Provider(s) of Service(s) | Recipient(s) of Service(s) | Specific Service(s) Covered | Income/ (Expense)* For Each Year of the Examination |
|---|---|---|---|---|---|
| 4. Service Agreement | September 19, 1983 | the Company; MetLife Securities, Inc. ("MSI") | the Company, MSI | Certain services, property, facilities and equipment, including but not limited to: accounting, tax and auditing services; legal services; actuarial services; employee benefit plans and personnel administration; sales services; software development services; electronic data processing operations; communications operations and investment services; electronic data processing equipment; business property; communications equipment and security vault; as each party may, from time to time, request. | 1999 - $ 11,490<br>2000 - $ 0<br>2001 - $20,372,864<br>2002 - $15,273,078<br>2003 - $17,598,890 |
| 5. Service Agreement | March 27, 1984 | the Company | Metropolitan Tower Realty Company, Inc. ("MTR") | Such services and facilities as MTR may determine to be reasonably necessary including but not limited to the following: appraisals; negotiation; architectural services; documentation; general property administration; legal; and accounting services. | 1999 - $10,543<br>2000 - $ 0<br>2001 - $ 21<br>2002 - $ 0<br>2003 - $ 0 |
| 6. Service Agreement | July 1, 1984 | the Company, MRM | Cross & Brown Company ("CRB"). Cross & Brown Company was dissolved in May 2000. | Such services and facilities as CRB may determine to be reasonably necessary including but not limited to the following: appraisals, negotiation, architectural services, documentation, general property administration, and accounting services. | 1999 - $23,520<br>2000 - $ 0<br>2001 - $ 0<br>2002 - $ 0<br>2003 - $ 0 |

| Type of Agreement | Effective Date | Provider(s) of Service(s) | Recipient(s) of Service(s) | Specific Service(s) Covered | Income/ (Expense)* For Each Year of the Examination |
|---|---|---|---|---|---|
| 7. Sales and Administrative Services Agreement | June 1, 1987 | the Company, Metropolitan Tower Life Insurance Company ("MTL") | the Company, MTL | Certain services, property, facilities and equipment, including but not limited to: accounting, tax and auditing services; legal services; actuarial services; employee benefit plans and personnel administration; sales services; software development services; electronic data processing operations; communications operations and investment services; electronic data processing equipment; business property; communications equipment and security vault; as each party may, from time to time, request. | 1999 - $ 85,318<br>2000 - $ 0<br>2001 - $1,132,258<br>2002 - $1,028,883<br>2003 - $ 204,635 |
| 8. Service Agreement | November 1, 1987 | the Company | Seguros Genesis, S.A. (Spain) | Administrative and managerial services. | 1999 - $0<br>2000 - $0<br>2001 - $0<br>2002 - $0<br>2003 - $0 |
| 9. Service Agreement | December 23, 1987 | the Company | MetLife Real Estate Advisors, Inc. ("MRE Advisors"). MRE Advisors was dissolved in September 1999. | Such services and facilities as MRE Advisors may determine to be reasonably necessary including but not limited to the following: appraisals; negotiation; architectural services; documentation; general property administration; and accounting services. | 1999 - $1,120<br>2000 - $ 0<br>2001 - $ 0<br>2002 - $ 0<br>2003 - $ 0 |
| 10. Service Agreement | May 15, 1988 | the Company | Seguros Genesis, S.A. (Spain) | Technical and system support services. | 1999 - $0<br>2000 - $0<br>2001 - $0<br>2002 - $0<br>2003 - $0 |

| Type of Agreement | Effective Date | Provider(s) of Service(s) | Recipient(s) of Service(s) | Specific Service(s) Covered | Income/ (Expense)* For Each Year of the Examination |
|---|---|---|---|---|---|
| 11. Service Agreement | June 29, 1992 | the Company | MetLife Mexico S.A. (f/k/a Seguros Genesis, S.A. Mexico) | Administrative, financial and technical services. | 1999 - $0<br>2000 - $0<br>2001 - $0<br>2002 - $0<br>2003 - $0 |
| 12. Service Agreement | October 29, 1992 | the Company and MetLife Investments Limited | the Company and MetLife Investments Limited | Certain services, property, facilities and equipment, including but not limited to: accounting, tax and auditing services; legal services; actuarial services; employee benefit plans and personnel administration; sales services; software development services; electronic data processing operations; communications operations and investment services; electronic data processing equipment; business property; communications equipment and security vault; as each party may, from time to time, request. | 1999 - $(4,760,922)<br>2000 - $(5,386,470)<br>2001 - $(5,596,794)<br>2002 - $(7,541,054)<br>2003 - $(7,754,113) |
| 13. Service Agreement | December 22, 1993 | the Company | SSR Realty Advisors, Inc.<br><br>SSRM Holdings was sold in January 2005 | Administrative and other services and facilities, upon request. | 1999 - $ 18,028<br>2000 - $(10,029,800)<br>2001 - $(14,179,179)<br>2002 - $(10,753,408)<br>2003 - $(10,837,548) |
| 14. Service Agreement | July 1, 1995 | the Company | Metropolitan Life Insurance Company of Hong Kong Limited | Administrative, technical and managerial services. | 1999-$ 0<br>2000-$ 0<br>2001-$(2,462,017)<br>2002-$ 0<br>2003-$ 0 |

| Type of Agreement | Effective Date | Provider(s) of Service(s) | Recipient(s) of Service(s) | Specific Service(s) Covered | Income/ (Expense)* For Each Year of the Examination |
|---|---|---|---|---|---|
| 15. Administrative Services Agreement | August 30, 1996 | the Company, NELICO | the Company, NELICO | NELICO provided administrative and other services in respect of certain policies and annuity contracts; the Company and NELICO provided such other administrative services as the other shall have requested including but not limited to; new product development; accounting; auditing services; risk management services; legal services; actuarial services; sales services; software development services; electronic data processing operations; communications operations and investment services. | 1999 - $ 300<br>2000 - $ (43,944,963)<br>2001 - $224,358,634<br>2002 - $ 1,806,073<br>2003 - $ (1,185,327) |
| 16. Service Agreement | January 18, 1998 | the Company | P.T. MetLife Sejahtera | Technical, administrative and managerial services. | 1999 - $0<br>2000 - $0<br>2001 - $0<br>2002 - $0<br>2003 - $0 |

| Type of Agreement | Effective Date | Provider(s) of Service(s) | Recipient(s) of Service(s) | Specific Service(s) Covered | Income/ (Expense)* For Each Year of the Examination |
|---|---|---|---|---|---|
| 17. Service Agreement | April 1, 2000 | the Company | MetLife, Inc. ("MET") | Such services and facilities as MET may determine to be reasonably necessary, including but not limited to the following services: accounting, tax and auditing services; legal services; actuarial services; employee benefit plans and personnel administration; sales services; software development services; electronic data processing operations; communications operations and investment services; and the following facilities: computer hardware and software; business property; and communications equipment. | 2000 - $ 0<br>2001 - $3,556,483<br>2002 - $4,642,572<br>2003 - $8,369,170 |
| 18. Service Agreement | October 30, 2000 | the Company | Exeter Reassurance Company, Ltd. ("Exeter") | Such services and facilities as Exeter may determine to be reasonably necessary, including but not limited to the following services: accounting, tax and auditing services; legal services; actuarial services; employee benefit plans and personnel administration; sales services; software development services; electronic data processing operations; communications operations and investment services; and the following facilities: computer hardware and software; business property; and communications equipment. | 2000 - $ 0<br>2001 – $ 768,176<br>2002 - $1,113,677<br>2003 - $ 392,621 |

| Type of Agreement | Effective Date | Provider(s) of Service(s) | Recipient(s) of Service(s) | Specific Service(s) Covered | Income/ (Expense)* For Each Year of the Examination |
|---|---|---|---|---|---|
| 19. Service Agreement | February 28, 2001 | the Company | MetLife Bank, NA ("Bank") | Such services and facilities as Bank may determine to be reasonably necessary, including but not limited to the following services: accounting, tax and auditing services; legal services; actuarial services; employee benefit plans and personnel administration; sales services; software development services; electronic data processing operations; communications operations and investment services; and the following facilities: computer hardware and software; business property; and communications equipment. | 2001 - $29,726,947<br>2002 - $ 4,284,316<br>2003 - $ 4,531,097 |
| 20. Service Agreement | December 10, 2001 | the Company | Metropolitan Insurance and Annuity Company ("MIAC") | Such services and facilities as MIAC may determine to be reasonably necessary, including but not limited to the following services: accounting, tax and auditing services; legal services; actuarial services; employee benefit plans and personnel administration; sales services; software development services; electronic data processing operations; communications operations and investment services; and the following facilities: computer hardware and software; business property; and communications equipment. | 2001 - $ 0<br>2002 - $22,856,992<br>2003 - $21,462,776 |

| Type of Agreement | Effective Date | Provider(s) of Service(s) | Recipient(s) of Service(s) | Specific Service(s) Covered | Income/ (Expense)* For Each Year of the Examination |
|---|---|---|---|---|---|
| 21. Master Services Agreement | December 31, 2002 | the Company | Various non-subsidiary affiliates of the Company | Services of a type similar to those that the Company customarily performs in the course of its own operations, and facilities and equipment, as the recipient may determine to be reasonably necessary for the conduct of its operations, including but not limited to the following services: legal; communications; human resources; broker-dealer; general management; controller; investment management; actuarial; treasury; benefits management; systems and technology; adjusting and claims; underwriting and policyholder services; and the following facilities and equipment: computer hardware and software; business property and communication equipment. | 2003 - $295,774,907 |
| 22. Service Agreement | January 1, 2003 | MetLife Group, Inc. | the Company, First MetLife Investors Insurance Company | Personnel, on an as needed basis, qualified to perform services including the following: legal; communications; human resources; broker-dealer; general management; controller; actuarial; treasury; benefits management; information systems and technology; claims; underwriting; and policyholder services. | 2003 - $(1,770,344,575) |

| Type of Agreement | Effective Date | Provider(s) of Service(s) | Recipient(s) of Service(s) | Specific Service(s) Covered | Income/ (Expense)* For Each Year of the Examination |
|---|---|---|---|---|---|
| 23. Investment Personnel Services Agreement | January 1, 2003 | MetLife Group, Inc. | the Company, First MetLife Investors Insurance Company | Personnel, on an as needed basis, qualified to perform investment management services including the following: asset management, including investment advice relating to the recipient's general accounts and in connection with the recipient's contractual obligations to third parties, including separate accounts, affiliates and mutual funds; trade processing and oversight of custodian and investment management relationships with third party managers; asset/liability management and investment accounting services; and review and/or preparation of internal investment accounting reports, Schedule D submissions, and statutory schedules for recipient's statutory reports. | 2003 - $ 0 |

* Amount of Income or (Expense) Incurred by the Company

In line with efforts to create a less complex, more flexible organizational structure consistent with that of other publicly traded companies, MetLife Inc. established MetLife Group, Inc. as an employee services company to provide personnel to support all activities of the MetLife enterprise.

The examiner notes that there are a number of service agreements included in the aforementioned table where services are no longer being provided. The Company has agreed to withdraw several of the agreements in question (agreements 3, 5, 6, 8, 9, 10, and 16 in the aforementioned table).

Section 1505(d) of the New York Insurance Law states, in part:

> "The following transactions between a domestic controlled insurer and any person in its holding company system may not be entered into unless the insurer has notified the superintendent in writing of its intention to enter into any such transaction at least thirty days prior thereto, or such shorter period as he may permit, and he has not disapproved it within such period . . .
> (2) reinsurance treaties or agreements;
> (3) rendering of services on a regular or systematic basis . . ."

A review of reinsurance agreements within the Company's holding company system revealed that the Company entered into six reinsurance agreements with affiliates in 2004 without filing the agreements with the Superintendent 30 days prior to entering into such agreements. Three of the reinsurance agreements were with First MetLife Investors Insurance Company regarding certain level term insurance products (all effective February 1, 2004). The other three reinsurance agreements were with MetLife Investors USA Insurance Company regarding certain universal life and level term insurance products (two agreements effective February 1, 2004, and the third effective July 1, 2004). The Company did not file any of the agreements until June 17, 2005.

The Company violated Section 1505(d)(2) of the New York Insurance Law by failing to file six reinsurance treaties with the Superintendent at least 30 days prior to entering into such reinsurance treaties with its affiliates.

In addition, the Company had a number of reinsurance treaties in effect with non-subsidiary affiliates as of December 31, 2003, that were formerly subsidiaries (prior to the restructuring). Although these treaties did not have to be filed with the Superintendent when they were entered into, once the subsidiaries became non-subsidiary affiliates (because of the restructuring), the reinsurance agreements should have been filed under Section 1505(d)(2) of the New York Insurance Law since the reinsurance treaties continued to be in effect. The Company has agreed to file the reinsurance treaties still in effect between the Company and its former subsidiaries that have now become sister affiliates.

C. Management

The Company's by-laws provide that the board of directors shall be comprised of not less than 13 and not more than 30 directors. Directors are elected for a period of one year at the annual meeting of the stockholders held on the fourth Tuesday of April of each year. As of December 31, 2003, the board of directors consisted of 16 members. In 2003, the Company's board met in February, March, April, June, July, September, October, and December.

The 16 board members and their principal business affiliation, as of December 31, 2003, were as follows:

| Name and Residence | Principal Business Affiliation | Year First Elected |
|---|---|---|
| Curtis H. Barnette *<br>Bethlehem, PA | Counsel<br>Skadden, Arps, Slate, Meagher & Flom LLP and Affiliates | 1994 |
| Robert H. Benmosche<br>Wesley Hills, NY | Chairman of the Board, President and Chief Executive Officer<br>Metropolitan Life Insurance Company | 1997 |
| Gerald Clark<br>Madison, NJ | Vice Chairman of the Board and Chief Investment Officer<br>Metropolitan Life Insurance Company | 1997 |
| John C. Danforth *<br>St. Louis, MO | Partner<br>Bryan Cave LLP | 2000 |
| Burton A. Dole *<br>Pauma Valley, CA | Former Chairman (Retired)<br>Puritan Bennett | 1996 |
| James R. Houghton *<br>Corning, NY | Chairman and Chief Executive Officer<br>Corning Incorporated | 1975 |
| Harry P. Kamen<br>New York, NY | Former Chairman and Chief Executive Officer (Retired)<br>Metropolitan Life Insurance Company | 1992 |
| Helene L. Kaplan *<br>New York, NY | Counsel<br>Skadden, Arps, Slate, Meagher & Flom LLP and Affiliates | 1987 |
| John M. Keane *<br>Washington DC | Former General (Retired)<br>United States Army | 2003 |

| Name and Residence | Principal Business Affiliation | Year First Elected |
|---|---|---|
| Catherine R. Kinney *<br>New York, NY | Co-Chief Operating Officer and President<br>New York Stock Exchange | 2002 |
| Charles M. Leighton *<br>Bolton, MA | Former Chairman and Chief Executive Officer (Retired)<br>CML Group, Inc. | 1996 |
| Stewart G. Nagler<br>Great Neck, NY | Former Vice Chairman of the Board and Chief Financial Officer<br>Metropolitan Life Insurance Company | 1997 |
| John J. Phelan *<br>Locust Valley, NY | Former Chairman and Chief Executive Officer (Retired)<br>New York Stock Exchange | 1985 |
| Hugh B. Price *<br>New Rochelle, NY | Senior Advisor<br>Piper Rudnick LLP | 1994 |
| Kenton J. Sicchitano<br>Weston, MA | Former Global Managing Partner (Retired)<br>PricewaterhouseCoopers | 2003 |
| William C. Steere *<br>Rye, NY | Chairman and Chief Executive Officer<br>Pfizer Inc. | 1997 |

* Not affiliated with the Company or any other company in the holding company system

In January 2004, Gerald Clark retired from the board and was replaced by Sylvia M. Matthews. In March 2004, Catherine R. Kinney resigned from the board and was replaced by Cheryl W. Grise. In April 2004, John J. Phelan retired from the board. In June 2004, John C. Danforth resigned and Stewart G. Nagler retired from the board.

The examiner's review of the minutes of the meetings of the board of directors and its committees indicated that meetings were well attended and that each director attended a majority of meetings.

The following is a listing of the principal officers of the Company as of December 31, 2003:

| Name | Title |
|---|---|
| Robert H. Benmosche | Chairman of the Board, President and Chief Executive Officer |
| William J. Wheeler | Executive Vice President and Chief Financial Officer |
| Carl R. Henrikson | President, U.S. Insurance and Financial Services |
| William J. Toppeta | President, International Operations |
| Lisa M. Weber | Senior Executive Vice President and Chief Administrative Officer |
| Gary A. Beller | Senior Executive Vice President |
| Catherine A Rein | Senior Executive Vice President |
| Daniel J. Cavanagh | Executive Vice President |
| Leland C. Launer Jr. | Executive Vice President and Chief Investment Officer |
| James L. Lipscomb | Executive Vice President and General Counsel |
| Anthony J. Williamson | Senior Vice President and Treasurer |
| Anthony E. Amodeo | Vice President and Senior Actuary |
| Gwenn L. Carr | Vice President and Secretary |
| Timothy L. Journy | Vice President and Controller |

David Rupper is the designated consumer services officer per Section 216.4(c) of Department Regulation No. 64.

D. Territory and Plan of Operation

The Company is authorized to write life insurance, annuities and accident and health insurance as defined in paragraphs 1, 2 and 3 of Section 1113(a) of the New York Insurance Law.

The Company is licensed to transact business in all fifty states, the District of Columbia, Puerto Rico, the U. S. Virgin Islands and Canada.

In 2003, 18.41% of life premiums, 12.20% of annuity considerations, 11.40% of accident and health premiums, 85.37% of deposit type funds and 29.34% of other considerations were received from New York. Policies are written on a participating and non-participating basis.

On the date of demutualization, April 7, 2000, the Company established a closed block for the benefit of individual participating policyholders who were expected to receive ongoing dividend payments as part of their policies. The Company designated sufficient assets that would generate cash flows to support all future benefit and dividend payments. These cash flows are expected to be sufficient to pay each policyholder, including the last surviving individual, a commensurate amount of cash flow for policyholder benefits and dividends.

The following tables show the percentage of direct premiums received, by the top five states, and by major lines of business for the year 2003:

| Life Insurance Premiums | |
|---|---|
| New York | 18.41% |
| California | 7.46 |
| Texas | 6.68 |
| New Jersey | 6.50 |
| Illinois | 5.73 |
| Subtotal | 44.78% |
| All others | 55.22 |
| Total | 100.00% |

| Annuity Considerations | |
|---|---|
| New York | 12.20% |
| New Jersey | 8.17 |
| Pennsylvania | 7.97 |
| California | 7.39 |
| Florida | 5.58 |
| Subtotal | 41.31% |
| All others | 58.69 |
| Total | 100.00% |

| Accident and Health Insurance Premiums | |
|---|---|
| California | 12.70% |
| New York | 11.40 |
| Texas | 7.35 |
| Florida | 5.60 |
| Illinois | 5.31 |
| Subtotal | 42.36% |
| All others | 57.64 |
| Total | 100.00% |

| Deposit Type Funds | |
|---|---|
| New York | 85.37% |
| Massachusetts | 4.62 |
| California | 2.89 |
| Illinois | 2.52 |
| New Jersey | 2.05 |
| Subtotal | 97.45% |
| All others | 2.55 |
| Total | 100.00% |

| Other Considerations | |
|---|---|
| New York | 29.34% |
| Massachusetts | 9.61 |
| California | 8.17 |
| Georgia | 5.96 |
| Illinois | 4.95 |
| Subtotal | 58.03% |
| All others | 41.97 |
| Total | 100.00% |

The Company offers a wide variety of products. Individual products offered by the Company include traditional life, universal and variable life, disability and long-term care insurance, as well as qualified and non-qualified variable and fixed annuities. The markets targeted for individual insurance include, the middle-income, affluent and business owner markets.

Group products offered by the Company include term life, universal and variable universal life, general and separate account annuities, accidental death and dismemberment and survivor benefits, dental, short and long-term disability, and long-term care insurance. The markets targeted for group insurance include small, medium and large employers, either as an integrated employee benefits package or as a stand alone product offering.

Retirement and savings products offered by the Company include administrative services to sponsors of 401(k) and other defined contribution plans and guaranteed interest products. The markets targeted for retirement and savings products include the small and middle market. The Company offers a variety of guaranteed interest contracts and funding arrangements for qualified retirement and savings plans.

The Company's agency operations are conducted through its career agency force, independent agents, financial institutions, affiliated broker/dealers, third party marketing organizations, including direct marketing efforts, affinity groups and joint ventures.

E. Reinsurance

As of December 31, 2003, the Company had reinsurance treaties in effect with 76 companies, of which 56 were authorized or accredited. The Company's life and accident and health business is reinsured on a coinsurance, modified-coinsurance, and/or yearly renewable term basis. Reinsurance is provided on an automatic and/or facultative basis.

The maximum retention limit for single individual life contracts is $25,000,000. The maximum retention limit for joint life contracts is $30,000,000. The total face amount of life insurance ceded as of December 31, 2003, was $347,208,885,538 which represents 16.5% of the total face amount of life insurance in force. Reserve credit taken for reinsurance ceded to unauthorized companies, totaling $1,712,400,223, was supported by letters of credit, trust agreements and/or funds withheld.

The Company understated the liability for unauthorized reinsurance by $10,505,306, due to the omission of five reinsurance treaties ceded to unauthorized reinsurers from part 4 of Schedule S of the annual statement. The Company corrected this understatement in the 2004 annual statement.

The total face amount of life insurance assumed as of December 31, 2003, was $107,036,597,532.

1. Reinsurance Recoverable

The 2003 National Association of Insurance Commissioners ("NAIC") Annual Statement Instructions for "Reinsurance recoverable on paid losses" states that companies should:

> "Report reinsured claim amounts paid by the company but not yet reimbursed by the reinsurer."

The Company used estimates to report the asset on page 2, line 13.1 of the annual statement, "Amounts recoverable from reinsurers," even though the Company should have known the precise amounts involved since this represents reinsurance recoverable on claims already paid by the Company. The Company used historical claims estimates for $43,543,549 out of the total asset amount of $71,722,950.

The examiner recommends that in the future the Company report only identifiable claim amounts paid but not reimbursed by the reinsurer on page 2, line 13.1 of the annual statement for "Amounts recoverable from reinsurers."

2. Reinsurance Insolvency Clause

Section 1308(a)(2)(A) of the New York Insurance Law states, in part:

> "No credit shall be allowed, as an admitted asset or deduction from liability, to any ceding insurer for reinsurance ceded, renewed, or otherwise becoming effective after January first, nineteen hundred forty, unless:
> (i) the reinsurance shall be payable by the assuming insurer on the basis of the liability of the ceding insurer under the contracts reinsured without diminution because of the insolvency of the ceding insurer . . . "

Reinsurance treaties numbered 13663, 16730, 16740 and 17030 with ReliaStar Life Insurance Company contain the following insolvency clause language:

<u>Treaty No. 13663</u>

> "The Reinsurer will make payments directly to the Company or its Successor, **with reasonable provisions for verification,** without diminution because of the Insolvency of the Company" (emphasis added)

Treaties Nos. 16730, 16740, 17030

"In the event of insolvency of the Reinsured and the appointment of a liquidator, receiver, conservator or statutory successor, this reinsurance shall be payable immediately upon demand, **with reasonable provision for verification, on the basis of the liability of the Reinsured** . . . without diminution because of the insolvency . . . " (emphasis added)

Section 1308(a)(2)(A)(i) of the New York Insurance Law does not provide for the wording "with reasonable provision(s) for verification" in the insolvency clause as used in reinsurance agreements noted above. The reinsurance should be payable "on the basis of the liability of the ceding insurer under the contracts reinsured without diminution because of the insolvency of the ceding insurer."

The examiner recommends that the Company revise the four reinsurance agreements with ReliaStar Life Insurance Company so that the insolvency clause complies with Section 1308(a)(2)(A)(i) of the New York Insurance Law.

3. Reinsurance Reports

Section 125.5(b) of Department Regulation No. 20 states, in part:

"(1) Notwithstanding the provisions of subdivisions (a) of this section or the amounts of funds withheld under a reinsurance agreement from an unauthorized insurer on behalf of such reinsurance, credit taken by a ceding insurer for reinsurance ceded to an unauthorized insurer shall not exceed the aggregate of the net amount of reserves plus the liability for any unallocated amounts which has been set up and reported to the ceding insurer as being held by the assuming unauthorized insurer and by each subsequent retrocessionaire on behalf of such reinsurance . . .
(4) The report referred to in subdivision (b)(1) of this section shall be obtained by the ceding insurer from:
(i) the assuming insurer, if accredited in this state, as to the total net reserves held by it and by all retrocessionaires, or
(ii) the assuming insurer and from each of the retrocessionaires with respect to the net reserves held by each of them. Each such report shall be in writing, signed by an officer of the assuming insurer or the retrocessionaire which provided it and obtained by the ceding insurer prior to the filing date of ceding insurer's annual and quarterly statement. Such reports shall be maintained by the ceding insurer for three years or until the conclusion of the next regular examination conducted by the insurance department of its state of domicile, whichever is later. The superintendent may approve a plan of compliance submitted by an accredited reinsurer which would permit a certification to be attached to a reinsurance agreement with a ceding insurer in lieu of obtaining such reports. "

The Company did not receive any reserve credit reports from assuming reinsurers as well as any retrocessionaires to support the reinsurance reserve credits taken in the Company's annual statement. In fact, the Company did not have any procedures in place to obtain these reports during the examination period. The Company took reserve credits totaling $116,890,102 as of December 31, 2003 under reinsurance contracts with unauthorized reinsurers whereby the required reserve credit reports were not obtained.

The Company violated Section 125.5(b)(1) of Department Regulation No. 20 for taking reserve credit without obtaining reports from assuming insurers that identified the aggregate of the net amount of reserves plus the liability for any unallocated amounts held by the assuming unauthorized insurers and by each subsequent retrocessionaire on behalf of such reinsurance.

## 4. SIGNIFICANT OPERATING RESULTS

Indicated below is significant information concerning the operations of the Company during the period under examination as extracted from its filed annual statements. Failure of items to add to the totals shown in any table in this report is due to rounding.

The following table indicates the Company's financial growth (decline) during the period under review:

| | December 31, 1998 | December 31, 2003 | Increase (Decrease) |
|---|---|---|---|
| Admitted assets | $178,136,086,780 | $229,125,885,765 | $50,989,798,985 |
| Liabilities | $170,748,249,663 | $221,147,988,021 | $50,399,738,358 |
| Common capital stock | $ 0 | $ 4,944,667 | $ 4,944,667 |
| Surplus notes | 1,547,665,056 | 847,830,497 | (699,834,559) |
| Gross paid in and contributed surplus | 0 | 5,280,420,672 | 5,280,420,672 |
| Group life insurance contingency reserve for epidemics | 937,299,000 | 0 | (937,299,000) |
| Tax contingency reserve | 49,269,818 | 0 | (49,269,818) |
| Special surplus fund reserve | 0 | 306,012,693 | 306,012,693 |
| Unassigned funds (surplus) | 4,853,603,243 | 1,538,689,215 | (3,314,914,028) |
| Total capital and surplus | $ 7,387,837,117 | $ 7,977,897,744 | $ 590,060,627 |
| Total liabilities, capital and surplus | $178,136,086,780 | $229,125,885,765 | $50,989,798,985 |

The increase in common capital stock was a result of the demutualization (becoming a stock company) in 2000. The decrease in surplus notes was due to the maturity of a $400 million surplus note and the redemption of a $300 million surplus note in the fourth quarter of 2003. The group life insurance contingency reserve for epidemics was eliminated in 2001. The tax contingency reserve, set up to pay potential taxes or penalties resulting from an Internal Revenue Service audit, was eliminated in 1999. The special surplus fund reserve was established in 2002 to cover the Company's potential liability in asbestos related lawsuits. The main driver for the reduction in unassigned funds was the demutualization that took place in 2000. When the Company demutualized, unassigned funds were drawn down and were replaced by paid-in capital. The remaining balance in unassigned funds represents normal activity (net income plus changes in surplus) that have occurred subsequent to the demutualization.

The Company's invested assets as of December 31, 2003, exclusive of separate accounts, were mainly comprised of bonds (72.3%), and mortgage loans (15.3%).

The majority (91.7%) of the Company's bond portfolio, as of December 31, 2003, was comprised of investment grade obligations.

The following is the net gain (loss) from operations by line of business after federal income taxes but before realized capital gains (losses) reported for each of the years under examination in the Company's filed annual statements:

| | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|
| Industrial life | $ 72,049,011 | $ 87,187,985 | $130,312,750 | $ 25,788,337 | $ 21,004,913 |
| Ordinary: | | | | | |
| Life insurance | $ (6,422,274) | $ 272,909,563 | $448,926,443 | $ 236,302,747 | $ 95,135,229 |
| Individual annuities | 155,707,986 | 65,963,717 | 95,039,349 | 17,848,048 | (14,361,217) |
| Supplementary contracts | 31,672,891 | 106,638,750 | 71,643,119 | 82,424,040 | 124,441,683 |
| Total ordinary | $ 180,958,603 | $ 445,512,030 | $615,608,911 | $ 336,574,835 | $ 205,215,695 |
| Group: | | | | | |
| Life | $ 295,091,683 | $ 263,295,655 | $225,667,250 | $ 165,257,448 | $ 182,191,541 |
| Annuities | 410,487,036 | 246,912,651 | 4,765,473 | 471,944,582 | 391,613,347 |
| Total group | $ 705,578,719 | $ 510,208,306 | $230,432,723 | $ 637,202,030 | $ 573,804,888 |
| Accident and health: | | | | | |
| Group | $ 97,168,860 | $ 133,287,960 | $(57,669,872) | $ 157,744,789 | $ 145,325,712 |
| Credit | 300,052 | 0 | 0 | 0 | 0 |
| Other | (54,546,919) | 36,096,139 | (14,911,461) | 12,504,279 | (3,437,783) |
| Total accident and health | $ 42,921,993 | $ 169,384,099 | $(72,581,333) | $ 170,249,068 | $ 141,887,929 |
| All other lines | $ 3,578,214 | $ 1,322,315 | $ 155,486 | $ 773,015,302 | $ 553,395,263 |
| Total | $1,005,086,540 | $1,213,614,735 | $903,928,537 | $1,942,829,572 | $1,495,308,688 |

The decrease in the "all other lines" gain in 2001 was due to increased reserves recorded in the Aviation Reinsurance product as a result of the September 11, 2001 tragedies. Prior to 2002 all other lines was comprised primarily of aviation reinsurance. However, in 2002, the Company was given permission by the Department to set up a Corporate Statutory Management

Account ("CSMA") under Department Regulation No. 33. Under the CSMA, investment income is re-allocated to the CSMA based on excess surplus calculated using the methodologies described in the Company's Regulation No. 33 filing approved by the Department. Total net investment income does not change as a result of the allocations. The increase of approximately $700 million in gains in 2002 was primarily due to investment income allocated to the CSMA from the other lines of business. Investment income was allocated to the CSMA from the other lines of business (decreasing their income) in the following proportions: Industrial - 4%, Ordinary Life Insurance - 28%, Ordinary Individual Annuities - 19%, Group Life Insurance - 14%, Group Annuities - 31%, and Group Health - 4%.

The 1999 ordinary life insurance loss was due to approximately $400 million recorded for sales practices litigation accruals and demutualization expenses incurred during that year.

The increases in ordinary life gains in 2000 and 2001 were due primarily to the acquisition of a large block of business from New England Life Insurance Company (the MetMass block of business). The primary reason for the decrease in 2002 and 2003 was due to the loss of investment income allocated to the CSMA.

The decreases in group life gains in 2002 and 2003 were driven primarily by the loss of investment income allocated to the CSMA. Also, the loss in group accident and health income in 2001 was driven by a $269 million restructuring charge for sales offices and other offices that were closed in 2001.

The group annuities net gain from operations was relatively consistent at around $400 million for 1999, 2002 and 2003. In 2000 and 2001 the net gain dropped off significantly (most significantly in 2001) primarily due to losses in the Separate Accounts and the Group Pension (401K) product lines of approximately $230 million and $180 million, respectively. The Separate Accounts product was terminated, due to ongoing losses as a result of the Company's inability to earn the rate guaranteed to the policyholders. Also in 2001, the Company exited from the Large Market Defined Contribution 401K business. In 2002, the net gain recovered, without the effects of the aforementioned product terminations, and in part, due to an expense accrual release that was related to the 2001 exit of the large market Defined Contribution 401K business.

The $190 million decrease in the group accident and health gain in 2001 was primarily due to an increase in reserves attributable to the events of September 11, 2001. The $215 million increase in 2002 was due to the increase of $278 million in health premiums which was mainly due to the continued growth and rate increases in dental, disability, long term care and small business center products. In addition, the aggregate reserve for institutional group health decreased by $106 million due in part due to the release of disability reserves recorded in 2001 as a result of the September 11, 2001 events.

The $90 million increase in other accident and health gains in 2000 reflects the disability income business for the entire year versus only two months in 1999. In October 1999, the Company completed the acquisition of disability income business from Lincoln National Life Insurance Company and Lincoln Life & Annuity Company of New York. The $51 million decrease in other accident and health gains in 2001 and the $27 million increase in 2002 were primarily due to increases in reserves in 2001 and decreases in reserves in 2002 which were attributable to the events of September 11, 2001.

## 5. FINANCIAL STATEMENTS

The following statements show the assets, liabilities, capital, and surplus as of December 31, 2003, as contained in the Company's 2003 filed annual statement, a condensed summary of operations and a reconciliation of the capital and surplus account for each of the years under review. These financial statements have been subjected to a limited audit or review as indicated in the Scope of Examination (item 2 of this report).

### A. ASSETS, LIABILITIES, CAPITAL AND SURPLUS AS OF DECEMBER 31, 2003

Admitted Assets

| | |
|---|---|
| Bonds | $121,526,988,130 |
| Stocks: | |
| Preferred stocks | 2,595,621,281 |
| Common stocks | 2,310,653,833 |
| Mortgage loans: | |
| First liens | 25,701,421,357 |
| Other than first liens | 28,301,564 |
| Real estate: | |
| Properties occupied by the company | 226,042,490 |
| Properties held for the production of income | 2,928,625,909 |
| Properties held for sale | 90,524,430 |
| Contract loans | 5,324,668,648 |
| Cash and short term investments | 3,320,321,032 |
| Other invested assets | 3,353,760,073 |
| Receivable for securities | 529,397,035 |
| Deposits in connection with investments | 27,607,453 |
| Derivative instruments | 181,365,519 |
| Uncollected premiums and agents' balances in the course of collection | 533,631,699 |
| Deferred premiums, agents' balances and installments booked but deferred and not yet due | 565,087,950 |
| Reinsurance ceded: | |
| Amounts recoverable from reinsurers | 71,722,950 |
| Other amounts receivable under reinsurance contracts | 244,317,304 |
| Net deferred tax asset | 728,781,284 |
| Electronic data processing equipment and software | 54,976,317 |
| Guaranty funds receivable or on deposit | 28,818,799 |
| Investment income due and accrued | 1,623,979,267 |
| Receivable from parent, subsidiaries and affiliates | 234,496,982 |
| Amounts receivable relating to uninsured accident and health plans | 11,086,761 |
| Administrative service agreements - fees due and unpaid | (8,125,502) |

| | |
|---|---|
| Other assets | 194,614,015 |
| Receivable from reinsurer | 8,040,766 |
| Value of company owned life insurance | 1,483,890,785 |
| Intangible asset offsetting minimum pension liability | 107,044,000 |
| Recoverable finite risk insurance | 1,184,191,164 |
| From separate accounts statement | 53,914,032,470 |
| Total admitted assets | $229,125,885,765 |

Liabilities, Capital and Surplus

| | |
|---|---|
| Aggregate reserve for life policies and contracts | $101,630,980,015 |
| Aggregate reserve for accident and health policies | 4,556,207,334 |
| Liability for deposit-type contracts | 20,097,054,094 |
| Policy and contract claims: | |
| Life | 1,748,565,169 |
| Accident and health | 190,684,266 |
| Policyholders' dividends and coupons due and unpaid | 39,778,150 |
| Provision for policyholders' dividends and coupons payable in following calendar year - estimated amounts: | |
| Dividends apportioned for payment | 1,397,711,900 |
| Dividends not yet apportioned | 102,829,904 |
| Premiums and annuity considerations for life and accident and health policies and contracts received in advance | 140,934,717 |
| Policy and contract liabilities: | |
| Surrender values on canceled policies | 1,004,877 |
| Provision for experience rating refunds | 1,702,214 |
| Other amounts payable on reinsurance assumed | 92,068,513 |
| Interest maintenance reserve | 783,822,712 |
| Commissions to agents due or accrued | 12,242,089 |
| Commissions and expense allowances payable on reinsurance assumed | 741,000 |
| General expenses due or accrued | 420,599,578 |
| Transfers to separate accounts due or accrued | (308,326,573) |
| Taxes, licenses and fees due or accrued | 103,203,247 |
| Federal and foreign income taxes | 1,075,790,356 |
| Unearned investment income | 8,201,162 |
| Amounts withheld or retained by company as agent or trustee | 22,035,785,012 |
| Amounts held for agents' account | 70,806,179 |
| Remittances and items not allocated | 205,922,243 |
| Net adjustment in assets and liabilities due to foreign exchange rates | 249,359,707 |
| Liability for benefits for employees and agents | 621,956,555 |
| Borrowed money and interest thereon | 3,503,542,903 |
| Miscellaneous liabilities: | |
| Asset valuation reserve | 2,468,366,406 |
| Reinsurance in unauthorized companies | 3,134,757 |
| Funds held under reinsurance treaties with unauthorized reinsurers | 241,107 |

| | |
|---|---|
| Payable to parent, subsidiaries and affiliates | 244,620,045 |
| Drafts outstanding | 140,505 |
| Payable for securities | 563,891,950 |
| Capital notes | 501,584,222 |
| Amounts held for deferred benefits | 1,122,902,955 |
| Other liabilities | 317,818,092 |
| Aviation reinsurance liability | 1,901,000 |
| FEGLI conversion pool funds | 12,775,552 |
| Legal contingency reserve | 1,415,104,905 |
| Deferred gain/loss on futures and hedging | 87,187,804 |
| Derivative instruments | 1,826,970,598 |
| From separate accounts statement | 53,798,180,800 |
| Total liabilities | $221,147,988,021 |
| Common capital stock | $ 4,944,667 |
| Surplus notes | 847,830,497 |
| Gross paid in and contributed surplus | 5,280,420,672 |
| Special surplus fund reserve | 306,012,693 |
| Unassigned funds (surplus) | 1,538,689,215 |
| Total capital and surplus | $ 7,977,897,744 |
| Total liabilities, capital and surplus | $229,125,885,765 |

The Company reported $22,035,785,012 as "Amounts withheld or retained by company as agent or trustee" in the 2003 filed annual statement. The majority of that amount, $21,476,329,015 or (97.5%), is actually the liability for securities lending collateral.

Paragraph 25 of NAIC Statement of Statutory Accounting Principles ("SSAP") No. 18 of the Accounting Practices and Procedures Manual states in part:

> " . . . if the collateral pledged is available for the general use of the transferor (unrestricted), then the collateral shall be recorded as an asset on the transferor's balance sheet and a **separate** liability shall be established on the transferor's balance sheet to record the obligation to return the collateral . . . " (emphasis added)

The Company's reporting of the liability for securities lending collateral is not in compliance with SSAP No. 18. In the interest of transparency, the examiner recommends that the Company report the securities lending collateral liability as a separate write-in item clearly identified as such.

## B. CONDENSED SUMMARY OF OPERATIONS

| | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|
| Premiums and considerations | $28,834,360,890 | $27,939,938,614 | $20,073,187,096 | $22,471,450,788 | $24,940,773,805 |
| Investment income | 8,687,868,906 | 8,822,522,105 | 9,035,892,909 | 9,102,882,157 | 8,840,484,264 |
| Net gain from operations from separate accounts | 5,129,087 | 13,273,437 | 25,910,579 | 0 | (3,908,242) |
| Commissions and reserve adjustments on reinsurance ceded | 640,895,542 | 27,042,947,371 | 1,660,939,216 | (1,433,056,132) | (1,673,559,198) |
| Miscellaneous income | 185,451,706 | 731,717,872 | 93,425,434 | 1,500,318,253 | 1,798,331,590 |
| Total income | $38,353,706,131 | $64,550,399,399 | $30,889,355,234 | $31,641,595,066 | $33,902,122,219 |
| Benefit payments | $32,177,568,450 | $32,907,017,943 | $24,728,118,130 | $20,938,115,824 | $20,760,042,194 |
| Increase in reserves | 802,990,054 | 1,674,961,735 | 5,168,009,866 | 4,525,089,527 | 3,374,495,284 |
| Commissions | 459,446,033 | 464,118,907 | 592,858,800 | 688,230,095 | 859,208,400 |
| General expenses and taxes | 2,452,531,283 | 2,545,281,303 | 2,678,173,955 | 2,384,947,366 | 2,602,616,112 |
| Increase in loading on deferred and uncollected premiums | 599,949 | 8,486,435 | (53,253,844) | (7,235,481) | (5,460,889) |
| Net transfers to (from) separate accounts | (1,293,376,260) | (2,615,053,802) | (3,615,009,650) | (550,653,651) | 391,934,663 |
| Miscellaneous deductions | 444,827,942 | 27,063,161,815 | (153,909,134) | 1,329,984,579 | 3,815,704,031 |
| Total deductions | $35,044,587,451 | $62,047,974,336 | $29,344,988,123 | $29,308,478,259 | $31,798,539,795 |
| Net gain (loss) | $ 3,309,118,680 | $ 2,502,425,063 | $ 1,544,367,111 | $ 2,333,116,807 | $ 2,103,582,424 |
| Dividends | 1,728,599,911 | 1,415,815,218 | 661,032,085 | 208,549,717 | 296,110,515 |
| Federal and foreign income taxes Incurred | 575,432,230 | (127,004,868) | (20,593,512) | 181,737,518 | 312,163,221 |
| Net gain (loss) from operations before net realized capital gains | $ 1,005,086,539 | $ 1,213,614,713 | $ 903,928,538 | $ 1,942,829,572 | $ 1,495,308,688 |
| Net realized capital gains (losses) | (215,642,525) | (186,859,504) | 1,878,396,069 | (464,530,457) | 673,424,432 |
| Net income | $ 789,444,014 | $ 1,026,755,209 | $ 2,782,324,607 | $ 1,478,299,115 | $ 2,168,733,120 |

The decrease in premiums and considerations and benefit payments between 2000 and 2001 was due to new reporting requirements associated with codification. Payments received for annuities without mortality risk were no longer considered premiums. Also, premiums were reduced because the Company ceded most of its closed block business.

The increase in commissions and reserve adjustments on reinsurance ceded and miscellaneous deductions in 2000 related to reserve adjustments on two large individual life modified coinsurance treaties enacted in late 2000. Under the treaties the Company ceded most of its closed block business that resulted from demutualization.

The increases in commissions in 2002 and 2003 were due to reinsurance assumed from several affiliates covering annuities that went into effect in the third quarter of 2001.

The decrease in general expenses and taxes in 2002 was due to: a $208 million restructuring charge in 2001 for the large market defined contribution product that was not repeated in 2002; and an $85 million decrease in expenses resulting from continuing expense management initiatives.

The increase in negative net transfers from Separate Accounts in 2000 was primarily related to group annuities whereby General Motors withdrew $1.5 billion of guaranteed interest contract ("GIC") funds. The further increase in negative net transfers in 2001 was due to General Motors withdrawing an additional $1.4 billion and Loomis Sayles withdrawing $1.7 billion in GIC funds.

The decrease in dividends in 2001 was due to approximately $800 million in dividends for the closed block business that were ceded to a group of outside reinsurers under a modco reinsurance treaty. The decrease in dividends in 2002 was due to a decrease in ordinary and industrial life dividends. In the fourth quarter of 2002, the Company's board of directors approved a reduction to the dividend scale to reflect the impact of the current low interest rate environment of the asset portfolios supporting these policies. Group life dividends also decreased as a result of unfavorable mortality experience of several large group clients.

The decrease in federal and foreign income taxes incurred between 1999 and 2000 was a result of decreased gains from operations and the benefit derived from the elimination of the surplus tax levied on mutual insurance companies following the demutualization of the Company.

The Company's realized losses in 1999 and 2000 were primarily driven by normal trading activity in the portfolio to meet asset/liability changes throughout the year. Credit concerns appeared in the portfolio in late 2000, which caused additional losses through sales or write-downs. The largest event centered on holdings in California public utilities, which experienced a financial crisis. The Company's realized losses in 2002 were primarily driven by credit concerns caused by an economic downturn and some major corporate scandals. As a result, the Company experienced an increase in credit-related losses through sales or write-downs. In addition, normal trading activity to reposition the portfolio to meet asset/liability management concerns also contributed to the losses in 2002.

## C. CAPITAL AND SURPLUS ACCOUNT

| | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|
| Capital and surplus, December 31, prior year | $7,387,837,118 | $ 7,630,059,415 | $ 7,212,809,288 | $5,357,698,345 | $ 6,985,991,119 |
| Net income | $ 789,444,014 | $ 1,026,755,209 | $ 2,782,324,607 | $1,478,299,115 | $ 2,168,733,120 |
| Change in net unrealized capital gains (losses) | (415,591,248) | (746,727,663) | (141,380,506) | (311,469,578) | 191,255,296 |
| Change in net unrealized foreign exchange capital gain (loss) | 0 | 0 | 0 | 0 | 137,808,086 |
| Change in net deferred income tax | 0 | 0 | 0 | (124,251,653) | 201,805,488 |
| Change in non-admitted assets and related items | (206,847,190) | (331,172,659) | (225,586,916) | (332,424,608) | (143,063,287) |
| Change in liability for reinsurance in unauthorized companies | (2,222,494) | 15,300,234 | 229,318 | 6,641 | 124,189 |
| Change in reserve valuation basis | 85,747,130 | 0 | (76,765,310) | 0 | 0 |
| Change in asset valuation reserve | 214,077,249 | (96,122,117) | (542,181,850) | 546,823,230 | 635,161,487 |
| Surplus (contributed to) withdrawn from separate accounts during Period | (18,912,666) | 20,235,539 | (97,958,208) | (69,983,368) | 16,029,020 |
| Other changes in surplus in separate accounts statement | 27,889,178 | (12,667,222) | (18,511,338) | (10,521,448) | 9,362,786 |
| Change in surplus notes | 0 | 0 | 126,957 | 38,484 | (699,873,043) |
| Cumulative effect of changes in accounting principles | 0 | 0 | 83,472,175 | 649,552,210 | 0 |
| Capital changes: Paid in | 0 | 4,944,667 | 0 | 500,090,172 | 0 |
| Surplus adjustments: | | | | | |
| Paid in | 0 | 4,754,164,533 | 0 | 0 | (90,172) |
| Change in surplus as a result of Reinsurance | 0 | 0 | 0 | 0 | (16,479,776) |

| | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|
| Dividends to stockholders | $ 0 | $ (763,000,000) | $(3,753,786,462) | $ (903,900,000) | $(1,448,100,000) |
| Income taxes and interest applicable to prior year | (14,180,628) | 23,419,275 | 0 | 0 | 0 |
| Separate Account seed money | 18,912,668 | (20,258,990) | 97,958,206 | 69,983,367 | 0 |
| Other surplus adjustments | 15,770,328 | (73,098,541) | 36,948,384 | (158,546) | (12,187,814) |
| Demutualization surplus adjustment | (251,864,044) | (4,219,022,392) | 0 | 0 | 0 |
| Prior period adjustment | 0 | 0 | 0 | 136,208,756 | (48,578,755) |
| Net change in capital and surplus | $ 242,222,297 | $ (417,250,127) | $(1,855,110,943) | $1,628,292,774 | $ 991,906,625 |
| Capital and surplus, December 31, current year | $7,630,059,415 | $ 7,212,809,288 | $ 5,357,698,345 | $6,985,991,119 | $ 7,977,897,744 |

## D. RESERVES

The Department conducted a review of reserves as of December 31, 2003. This review included an examination of related asset adequacy analysis in accordance with Department Regulation No. 126 and sound value requirements in accordance with Department Regulation No. 56.

During the review, concerns were raised with respect to reinvestment risks for the Company's Structured Settlement and Single Premium Immediate Annuity business, due to the prevailing low interest rate environment. The Company addressed these concerns by strengthening related reserves by the amount of $600 million as of December 31, 2004.

During the review, concerns were also raised with respect to certain reinsurance agreements for secondary guarantees on universal life insurance. These treaties failed to satisfy the conditions required by Department Regulation No. 102 to be eligible for coinsurance reserve credit; however, these reinsurance agreements remain eligible for yearly renewable term reserve credit. The net effect is disallowance of reserve credit in the amount of $13 million as of December 31, 2003, and in the amount of $43 million as of December 31, 2004. The Company has indicated that it has since recaptured the coverage provisions that gave rise to the reserve credits in question.

During the review, concerns were raised regarding the classification of certain GICs as cash flow matched for computing reserves pursuant to Department Regulation No. 128. The Company has agreed to address these concerns by revising their methodology consistent with the Department's position, which considers the Company's management practices, for calculating such reserves commencing with the December 31, 2005 reserve valuation.

During the review, concerns were raised regarding the lack of conservatism in certain assumptions with respect to the Company's LTC insurance reserves. The Company has agreed to refine the LTC reserve analysis and to strengthen reserves in a manner acceptable to the Department. Toward this end, the Company established additional LTC reserves in the amount of $50 million as of September 30, 2005. Major assumptions, e.g., morbidity, mortality, lapses, and investment returns were revised with the December 31, 2005 reserve analysis to more appropriately reflect Company experience and to incorporate margins for adverse deviation. These revised assumptions resulted in additional reserve strengthening of $400 million for a total strengthening in the amount of $450 million.

## 6. MARKET CONDUCT ACTIVITIES

The examiner reviewed various elements of the Company's market conduct activities affecting policyholders, claimants, and beneficiaries to determine compliance with applicable statutes and regulations and the operating rules of the Company.

### A. Advertising and Sales Activities

The examiner reviewed a sample of the Company's advertising files and the sales activities of the agency force including trade practices, solicitation and the replacement of insurance policies.

1. Section 51.6(b) of Department Regulation No. 60 states, in part:

> "Where a replacement has occurred or is likely to occur, the insurer replacing the life insurance policy or annuity contract shall . . .
> (2) Require with or as part of each application a copy of any proposal, including the sales material used in the sale of the proposed life insurance policy or annuity contract, and proof of receipt by the applicant of the 'IMPORTANT Notice Regarding Replacement or Change of Life Insurance Policies or Annuity Contracts' and the completed 'Disclosure Statement;'
> (3) Examine any proposal used, including the sales material used in the sale of the proposed life insurance policy or annuity contract, and the 'Disclosure Statement,' and ascertain that they are accurate and meet the requirements of the Insurance Law and this Part;
> (4) Within ten days of receipt of the application furnish to the insurer whose coverage is being replaced a copy of any proposal, including the sales material used in the sale of the proposed life insurance policy or annuity contract, and the completed 'Disclosure Statement' . . .
> (6) Where the required forms are received with the application and found to be in compliance with the Part, maintain copies of: any proposal, including the sales material used in the sale of the proposed life insurance policy or annuity contract; proof of receipt by the applicant of the 'IMPORTANT Notice Regarding Replacement or Change of Life Insurance Policies or Annuity Contracts;' the signed and completed 'Disclosure Statement;' and the notification of replacement to the insurer whose life insurance policy or annuity contract is to be replaced indexed by agent and broker, for six calendar years or until after the filing of the report on examination in which the transaction was subject to review by the appropriate insurance official of its state of domicile, whichever is later . . . "

Section 51.6(e) of Department Regulation No. 60 states:

> "Both the insurer whose life insurance policy or annuity contract is being replaced and the insurer replacing the life insurance policy or annuity contract shall establish and implement procedures to ensure compliance with the requirements of this Part. These procedures shall include a requirement that all material be dated upon receipt. Such insurers shall also designate a principal officer specifically responsible for the monitoring and enforcement of these procedures. All insurers covered under this Part shall furnish the Superintendent of Insurance with these procedures and the name and title of the designated principal officer by the effective date of this Part. Any changes in these procedures or the designated principal officer shall be furnished to the Superintendent of Insurance within thirty days of such change."

Section 243.2(b) of Department Regulation No. 152 states, in part:

> "Except as otherwise required by law or regulation, an insurer shall maintain:
> (1) A policy record for each insurance contract or policy for six calendar years after the date the policy is no longer in force or until after the filing of the report on examination in which the record was subject to review, whichever is longer . . . A policy record shall include . . .
> (iv) Other information necessary for reconstructing the solicitation, rating and underwriting of the contract or policy . . .
> (8) Any other-record for six calendar years from its creation or until after the filing of a report on examination or the conclusion of an investigation in which the record was subject to review. "

Section 51.6(b)(6) of Department Regulation No. 60 requires companies to maintain an index of replacements by agent. In order to review the Company's compliance with Department Regulation No. 60, the Company was asked to provide a data file listing all New York life insurance policy and annuity contract replacements occurring during the examination period (Request #2 dated February 11, 2004). In March 2004, in response to Request #2 the Company provided an inventory of 240 annuity replacements and an inventory of 7,706 life insurance replacements for New York. During discussions with the Company it was determined that most of the annuities did not, in fact, involve a replacement transaction as defined under Department Regulation No. 60. In a meeting with the Company to discuss the errors in the annuity replacement inventory the Company indicated that there was another annuity replacement inventory for variable annuities. The Company stated that the original inventory provided in response to Request # 2 consisted of fixed annuity replacements and there was an additional listing of variable annuity replacements. The Company provided the additional inventory of 762 variable annuity replacements for New York a couple of weeks later.

A sample of 250 New York life insurance replacements was selected for review on April 14, 2004. During the review of the policy files it was determined that a majority of the life insurance replacements were not subject to Department Regulation No. 60 because the new life insurance was not issued in New York. The Company explained that there was an error in the composition of the ‘state’ field in the inventory that the examiners used to extract New York replacements. The Company subsequently provided a revised inventory of life replacements and a different sample was selected.

The examiner then compared the annuity and life replacement inventories ultimately provided by the Company with the quarterly reports the Company filed with the Department over the course of the examination period, which identify cases where the replaced insurer did not send the Company (the replacing insurer) the information necessary to complete the Disclosure Statement in replacement transactions.

Based on the examiner’s review of the quarterly reports filed with the Department and the life and annuity replacement inventories provided by the Company, it is clear that the inventories provided to the examiners were significantly understated in that many replacements were left off the inventories.

The Company violated Section 51.6(b)(6) of Department Regulation No. 60 by failing to maintain a complete index of replacements. Since there were many items included in the Company’s replacement inventories that were not replacements as defined by Department Regulation No. 60, and the Company’s inventories of replacements did not include all replacements, the examiner was unable to select a representative sample of replacements for review. Notwithstanding, the examiner did review a sample of replacements based on the inventories provided by the Company.

The examiner reviewed a number of internal and external replacements involving both annuity contracts and life polices as follows:

| | Number of Replacements Reviewed | | |
|---|---|---|---|
| Type of Policy or Contract | Internal Replacements | External Replacements | Total Replacements |
| Fixed Annuities | 12 | 36 | 48 |
| Variable Annuities | 71 | 37 | 108 |
| Life Policies | 72 | 89 | 161 |
| Total | 155 | 162 | 317 |

In 18 of the 108 (17%) variable annuity replacements reviewed, it was indicated on the Disclosure Statement that sales material was used; however no sales material was maintained or referenced in the contract files. In 43 of the 108 (40%) variable annuity replacements reviewed, it was not indicated on the Disclosure Statement whether or not sales material was used and no sales material was maintained in the contract files.

In 9 of the 48 (19%) fixed annuity replacements reviewed, it was indicated on the Disclosure Statement that sales material was used; however no sales material was maintained or referenced in the contract files. In 23 of the 48 (48%) fixed annuity replacements reviewed, it was not indicated on the Disclosure Statement whether or not sales material was used and no sales material was maintained in the contract files. In addition, 6 of the 48 (13%) fixed annuity replacements reviewed did not include Disclosure Statements.

In 32 of the 161 (20%) life insurance replacements reviewed, it was indicated on the Disclosure Statement that sales material was used; however no sales material was maintained or referenced in the policy files. In 56 of the 161 (35%) life insurance policy replacements reviewed, it was not indicated on the Disclosure Statement whether or not sales material was used and no sales material was maintained in the policy files.

The Company violated Sections 51.6(b)(2), (b)(3) and (b)(6) of Department Regulation No. 60 for: failing to require with or as part of each application a copy of any proposal, including the sales material used in the sale of the proposed annuity contract or life insurance policy, and the proof of receipt by the applicant of the completed Disclosure Statement; failing to maintain any proposals, including the sales material used in the sale of the proposed annuity contract or life insurance policy; and failing to examine any proposal used, including the Disclosure

Statement, and ascertain that they were accurate and met the requirements of Department Regulation No. 60.

The examiner recommends that the Company ensure that its agents identify on the Disclosure Statement whether or not sales material is used in the sale of proposed life insurance policies and annuity contracts.

A review of the sample of 73 external annuity replacements (fixed and variable) during the examination period revealed that the Company did not maintain the notification of replacement to the insurer whose annuity contract was replaced. In addition, the Company did not maintain the documentation received from the replaced insurer that was used to complete the Disclosure Statement for its annuity replacements. The Company destroyed these replacement records in accordance with its established retention schedule; the Company indicated that its procedure was to maintain this information for only 90 days after which time the materials were destroyed. As a result of the destruction of these records, the examiner was unable to determine if the Company was in compliance with Department Regulation No. 60 during the examination period. A visit by the examiner to the Company's Denver annuity replacement service center confirmed that the aforementioned replacement documentation was only being maintained for 90 days during the examination period.

The Company violated Section 51.6(b)(6) of Department Regulation No. 60 and Section 243.2(b) of Department Regulation No. 152 for failing to maintain the notification of replacement to the insurer whose annuity contract was replaced and failing to maintain the documentation received from the replaced insurer that was used to complete the Disclosure Statement for its annuity replacements.

Pursuant to Section 51.6(b)(4) of Department Regulation No. 60, the Company was required to send, within ten days of receipt of the application, to the insurer whose coverage was being replaced, a copy of any proposal, including the sales material used in the sale of the proposed life insurance policy or annuity contract, and the completed Disclosure Statement. A review of the replacement files indicated that the Company did send the required information to the replaced insurer in some cases; however there was no indication that the information sent included a copy of any proposal, including the sales material used in the sale of the proposed annuity contract, or the Disclosure Statement.

The following was also noted in the review of external annuity replacements:

- in all 36 (100%) of the external fixed annuity replacements reviewed there was no indication that the aforementioned required information was ever sent;
- in 4 of the 37 (11%) external variable annuity replacements reviewed there was no indication that the aforementioned required information was ever sent;
- in 26 of the 37 (70%) external variable annuity replacements reviewed the replaced companies were furnished with the aforementioned required information more than ten days after the date the replacement application was received by the Company; and
- in 4 of the 37 (11%) external variable annuity replacements reviewed, the examiner could not determine whether the aforementioned required information was sent in a timely manner because the date-received stamp on the application was unreadable.

The Company violated Section 51.6(b)(4) of Department Regulation No. 60 for failing to furnish to the insurer whose coverage was being replaced a copy of any proposal, including the sales material used in the sale of the proposed annuity contract, and the completed Disclosure Statement within ten days of receipt of the application.

The Company's replacement procedures on file with the Department during the examination period, filed as required by Section 51.6(e) of Department Regulation No. 60, did not accurately reflect the Company's procedures for compliance with Department Regulation No. 60. Examples are listed below.

- The Company's procedures only note the Company's processing of replacements in Warwick, RI, where life insurance replacements are processed. The Company's Tulsa, OK, and Denver, CO, annuity replacement service centers are not noted in the filed procedures.
- The Company's procedures indicate that documentation explaining the reason a transaction is exempt from Department Regulation No. 60 is required to be maintained. No such documentation was maintained in any of the annuity files that the Company indicated were exempt from Department Regulation No. 60.
- The Company's procedures indicate that all sales material was to be submitted to the New Business Centers (e.g. Denver, CO and Warwick, RI). However, there was no evidence that any sales material was ever submitted to the New Business Centers.
- The Company's procedures indicate that all replacement documentation collected during the application process is to be microfilmed separate from the application and maintained

indefinitely for reference purposes. However, with respect to life and annuity replacements, the information received from the replaced insurer used to complete the Disclosure Statement, the notification and authorization to disclose policy information and the sales materials were not microfilmed.

The Company violated Section 51.6(e) of Department Regulation No. 60 for failing to follow its filed replacement procedures and failing to furnish changes to its replacement procedures within 30 days of such changes to the Superintendent.

The examiner was unable to determine if the Company was in compliance with Department Regulation No. 60 during the examination period with respect to annuity replacements since the Company destroyed certain replacement records in accordance with its established retention schedule and in violation of Department regulations as previously noted. As a result, the examiners visited the Company’s annuity replacement center located in Denver, CO to review current annuity replacement procedures and transactions. The results of the examiner’s review did not indicate any pattern of replacement violations other than those already noted above.

2. Section 3209(b) of the New York Insurance Law states, in part:

> "No policy of life insurance shall be delivered or issued for delivery in this state . . . unless the prospective purchaser has been provided with the following:
> (1) a copy of the most recent buyer's guide and the preliminary information required by subsection (d) of this section, at or prior to the time an application is taken. . . . "

Section 53-3.5(a) of Department Regulation No. 74 states, in part:

> "If a basic illustration is used by an insurance producer or other authorized representative of the insurer in the sale of a life insurance policy and the policy is applied for as illustrated, a copy of that illustration, signed in accordance with this Subpart, shall be submitted to the insurer at the time of policy application. A copy also shall be provided to the applicant . . . "

A review of universal life and variable universal life application files revealed that the Company did not provide the applicant with a written copy of the preliminary information or an illustration as a substitution for such preliminary information prior to or at the time of application for such policies.

The Company violated Section 3209(b)(1) of the New York Insurance Law and/or Section 53-3.5(a) of Department Regulation No. 74 by failing to provide the applicant with the preliminary information or an illustration, as applicable, prior to or at the time of application for universal life and variable universal life policies.

The examiner recommends that the Company review its policy files and identify all such cases where: 1) there is no signed statement by the applicant indicating receipt of the preliminary information or an illustration, as applicable; 2) the signed statement that the applicant received the preliminary information or illustration, as applicable, indicates it was provided after the policy was delivered; and 3) the signed statement that the applicant received the preliminary information or illustration, as applicable, indicates it was provided after the date of the application but prior to or at the time that the policy was delivered. The examiner also recommends that the Company develop and propose a plan of remediation acceptable to the Department which addresses the Company's failure to provide the required disclosure material (i.e., preliminary information or an illustration, as applicable) in a timely manner.

The examiner further recommends that the Company provide to the Department a plan to assure that, in the future, applicants are provided with the required disclosure in a timely manner in compliance with Section 3209 of the New York Insurance Law and Department Regulation No. 74.

B. Underwriting and Policy Forms

The examiner reviewed a sample of new underwriting files, both issued and declined, and the applicable policy forms.

1. Section 3201(b)(1) of the New York Insurance Law states, in part:

> "No policy form shall be delivered or issued for delivery in this state unless it has been filed with and approved by the superintendent as conforming to the requirements of this chapter and not inconsistent with law. . . . "

The Company used three different types of employee "enrollment/consent to insurance" forms, which contained health questions, for the issuance of its COLI group policies. These forms were utilized in conjunction with the issuance of three separate COLI group policies with a total of 286 certificate holders.

The Company violated Section 3201(b)(1) of the New York Insurance Law by using three "employee enrollment/consent to insurance" forms that were not filed with and approved by the Superintendent.

2. Section 54.7 of Department Regulation No. 77 states, in part:

> "The policy value and cash surrender value of each variable life insurance policy shall be determined at least monthly. A summary of the method of computation of cash surrender values and other nonforfeiture benefits shall be described in the policy; a complete statement of the method of computation shall be filed with the superintendent. Such method shall be in accordance with actuarial procedures that recognize the variable nature of the policy. The method of computation must be such that it complies with (a) or (b) of this section . . .
> (b) Alternative policy value and cash surrender value requirement.
> (4) In the case of standard medically underwritten lives, the mortality charges for life insurance on any insured under the policy may not exceed, prior to the operative date of subsection (k) of section 4221 of the Insurance Law, the 1958 CSO table; and on or after such operative date, the 1980 CSO with or without 10 year select mortality factors or any other table approved by regulation promulgated by the superintendent in accordance with section 4221(k)(9)(B)(vi), as substitutes for such tables . . . Mortality charges for substandard lives may be used on appropriate modification of the aforementioned tables as described or set forth in the policy. Otherwise, for purposes of this section, the mortality tables are those prescribed in section 4221, and for the mortality tables an insurer must

> elect an operative date of subsection (k) of section 4221, or such operative date is January 1, 1989 in absence of such election. ”

The Company issued variable universal life policies on juveniles. The application for such policies contained a question as to whether any person to be insured ever used tobacco products. In at least some if not all cases the application question was answered “no” and the policies were issued with a rating class of standard. Nevertheless, the maximum mortality rates in such cases were based on the 1980 CSO Smoker Table age at last birthday.

The application for these policies also contained medical questions. Section 54.7(b)(4) of Department Regulation No. 77 limits the maximum mortality charge for standard medically underwritten lives to the 1980 CSO table and any other table approved by Department Regulation. Section 57.4 of Department Regulation No. 113 permits the use of the 1980 CSO smoker tables subject to certain conditions. The conditions include the requirement that there be separate premium rates for smokers and nonsmokers. Since separate premium rates for smokers and nonsmokers were not available for juveniles, the smoker tables are not available for use with this policy and the maximum premium rates stated in the policy exceed those allowed by Section 54.7(b)(4) of Department Regulation No. 77.

The Company stated in actuarial material provided with the forms on which the juvenile policies were issued that, “consistent with our mortality experience, these guaranteed mortality costs are higher for substandard lives and for smaller face amounts.” Subsequently, the Company verified that maximum mortality for face amounts below $100,000.00 was based on 140% of 1980 CSO Composite mortality. While Department Regulation No. 77 provides for mortality charges above 1980 CSO Composite mortality for substandard lives, no such provision is made for small face amounts. Hence, the Company used guaranteed mortality charges in excess of those permitted when issuing policies with face amounts of less than $100,000.00.

The Company violated Section 54.7(b)(4) of Department Regulation No. 77 by having maximum cost of insurance rates stated in its juvenile and small face amount variable universal life policies in excess of those permitted.

The examiner recommends that the Company provide endorsements for all juvenile and small face amount policies where the maximum cost of insurance rates stated in the policies are in excess of those permitted by Department Regulation No. 77 as described above, for the purpose of reducing such maximum cost of insurance rates to the rates permitted by Department Regulation No. 77. Further, the examiner recommends that the Company review its small face amount and juvenile policies to determine which policies were charged more than the maximum mortality rates permitted by Department Regulation No. 77 and the amount of the excess, and report the results of the review to the Department. The examiner recommends that the Company provide the Department with the historic experience (deaths and exposures) and the history of cost of insurance rates charges for small face amount, juvenile, and smoker classes. Information should be provided by issue age, attained age, and period (year) of issue.

3. Section 3201(b)(1) of the New York Insurance Law states in part:

> "No policy form shall be delivered or issued for delivery in this state unless it has been filed with and approved by the superintendent as conforming to the requirements of this chapter and not inconsistent with law . . . "

> Department Circular Letter No. 33 (1998) advises:

> "This circular letter discusses the position of the New York State Insurance Department regarding the crediting of enhanced interest rates on dollar cost averaging accounts in variable annuity contracts and certificates.
> The Department has reviewed the applicable statutory provisions and has determined that Section 4232(a)(2) of the Insurance Law does not, in all instances, limit the additional amounts to be credited to those based on reasonable assumptions for the one year that some portion of the contract or certificate holder's money is in the dollar cost averaging account.
> The Department will now review the interest rate credited to each dollar cost averaging account to determine the reasonableness of the assumptions as to investment income, mortality and expenses used by each insurer given the unique nature of that product and the insurer's proposed method of recouping, over time, any additional amounts credited. In addition, for each product, disclosure must be provided to the consumer that is clear and complete and provides information to the consumer regarding all costs associated with the enhanced interest rate."

The Company issued certain variable annuity contracts with enhanced dollar cost averaging ("EDCA") accounts. The EDCA accounts were provided without disclosing any cost associated with the enhanced interest rate to the contractholder. Failure to state any cost related to the recovery of the enhancement is misleading. The issuance of annuity contracts without the required cost disclosure regarding its EDCA accounts constitutes using an approved policy form in an unapproved manner.

The Company violated Section 3201(b)(1) for using approved annuity contracts in an unapproved manner by issuing such variable annuity contracts without the required cost disclosure regarding its EDCA accounts, as advised by Department Circular Letter No. 33 (1998).

The examiner recommends that the Company review its contract files to identify the variable annuity contracts with EDCA accounts in order to provide the cost disclosure required by Department Circular Letter No. 33 (1998) to the affected contractholders. The examiner also recommends that the Company develop a cost disclosure statement to be provided in a timely manner to future contractholders.

C. Treatment of Policyholders

The examiner reviewed a sample of various types of claims, surrenders, changes and lapses. The examiner also reviewed the various controls involved, checked the accuracy of the computations and traced the accounting data to the books of account.

1. Section 3214(c) of the New York Insurance Law states, in part:

> "If no action has been commenced, interest upon the principal sum paid to the beneficiary or policyholder shall be computed daily at the rate of interest currently paid by the insurer on proceeds left under the interest settlement option, from the date of the death of an insured or annuitant in connection with a death claim on such a policy of life insurance or contract of annuity . . . to the date of payment and shall be added to and be a part of the total sum paid."

Office of General Counsel Opinion No. 92-46 dated March 17, 1992 states, in part:

> " . . . the interest will be calculated by whatever rate is in effect on each day under the interest settlement option, from the date of death to the date of payment. Therefore, the rate is subject to whatever rate fluctuations and changes which may occur during this period of time. This would be similar to having interest payments determined by the rate in effect under a money market fund during a specific period time, which rate may or may not vary during that period . . . "

The Company's procedure for the payment of interest on individual and group death claims is to pay interest from the date of death until the date of payment using the interest settlement option rate at the time of payment to calculate the interest amount to be paid. The interest should be calculated by using the interest settlement option rate that is in effect on each day, from the date of death to the date of payment.

The Company violated Section 3214(c) of the New York Insurance Law, and is not in compliance with Office of General Counsel Opinion No. 92-46 dated March 17, 1992, by failing to pay interest on death claims using the interest settlement option rate that is in effect on each day from the date of death to the date of payment.

2. Section 3203(a) of the New York Insurance Law states in part:

> "All life insurance policies, except as otherwise stated herein, delivered or issued for delivery in this state, shall contain in substance the following provisions, or provisions which the superintendent deems to be more favorable to policyholders . . .
> (15) that states on the policy data or policy specifications page of a participating cash value policy that dividends are not guaranteed and the insurer has the right to change the amount of dividend to be credited to the policy which may result in lower dividend cash values that were illustrated, or, if applicable, require more premiums to be paid than were illustrated . . .
> (16) that states on the policy data or policy specifications page of a life insurance policy subject to subsection (b) of section four thousand two hundred thirty-two of this chapter, to the extent applicable, that additional amounts are not guaranteed and the insurer has the right to change the amount of interest credited to the policy and the amount of cost of insurance or other expense charges deducted under the policy which may require more premium to be paid than was illustrated or the cash values may be less than those illustrated."

The Company issued life insurance policies subject to Section 4232(b) of the New York Insurance Law (i.e., crediting additional amounts) that did not include the policy provision required by Section 3203(a)(16) of the New York Insurance Law. The Company utilized policy forms 27-91, 97-89, 97-93 7.5 UL-90, 2JUL-91, and 7FV-93 from January 1, 1995 (the effective date of Section 3203(a)(16) of the New York Insurance Law) until July 2003 (when the policy forms were revised), which did not contain a statement that additional amounts are not guaranteed and the insurer has the right to change the amount of interest credited to the policy and the amount of cost of insurance or other expense charges deducted under the policy which may require more premium to be paid than was illustrated or the cash values may be less than those illustrated.

The Company violated Section 3203(a)(16) of the New York Insurance Law by issuing life insurance policies subject to Section 4232(b) of the New York Insurance Law without disclosing that additional amounts are not guaranteed and the insurer has the right to change the amount of interest credited to the policy and the cost of insurance or other expense charges deducted under the policy which may require more premium to be paid than was illustrated or the cash values may be less than those illustrated.

The Company issued participating cash value policies that did not include the policy provision required by Section 3203(a)(15) of the New York Insurance Law. The Company utilized policy forms 8-90(95), 2J-90(96), 6-91, 6PA-91 and 6-95 from January 1, 1995 (the effective date of Section 3203(a)(15) of the New York Insurance Law) until July 2003 (the date policy forms 8-90(95), 2J-90(96), 6-91, 6A-91 and 6-95 were revised), which did not contain a statement that dividends are not guaranteed and the insurer has the right to change the amount of dividend to be credited to the policy which may result in lower dividend cash values than were illustrated, or, if applicable, require more premiums to be paid than were illustrated.

The Company violated Section 3203(a)(15) of the New York Insurance Law by issuing participating cash value policies without disclosing that dividends are not guaranteed and the insurer has the right to change the amount of dividend to be credited to the policy which may result in lower dividend cash values than were illustrated, or, if applicable, require more premiums to be paid than were illustrated.

The aforementioned violations of Sections 3203(a)(15) and (16) of the New York Insurance Law came to the Department's attention in 2003 as a result of the Company's request to modify and correct two universal life policies that were approved under the Circular Letter No. 27 (2000) process. During that review it was discovered that the Company had not brought their current life policies into compliance with the statutory changes required by Sections 3203(a)(15) and (16) of the New York Insurance Law effective on January 1, 1995. The Department also became aware that despite the Company having been advised by Department letter dated January 17, 2001 that two of their submitted universal life policies (27-91(00) and 97-98(00)) did not contain the language required by Section 3203(a)(16), the Company continued to issue prior versions of those policies without the necessary modification required by law.

In addition, it came to the Department's attention that the Company had continued to issue two demutualization endorsements which were approved on August 27, 1999 on the condition that "New policy forms for each of the Company's individual life insurance policies, containing all of the revisions outlined in the endorsement must be submitted for our approval no later than 6 months from the effective date of the demutualization." The effective date of the Company's demutalization was April 7, 2000. While the Company had submitted a package of their individual life forms in December 2000 to comply with the conditional approval letter, the Company chose not to respond to the Department's comment letter of January 17, 2001 (referenced above) which advised of the Section 3203(a)(16) issue and also continued to use the endorsements.

The Company's actions or lack of action described above are an indication that the Company negligently failed to comply with Section 3203 of the New York Insurance Law.

There were 129,934 policies affected by the violation of 3203(a)(15) of the New York Insurance Law and 10,434 policies affected by the violation of 3203(a)(16) of the New York Insurance Law. The Company sent endorsements to all policyholders affected by these violations during the period February 2 through February 4, 2004, to correct the absence of the policy provisions required by Sections 3203(a)(15) and 3203(a)(16) of the New York Insurance Law.

The Department is very concerned with the Company's failure to provide important consumer disclosures as required by statute and regulation. The need for disclosure in participating cash value life insurance policies and life insurance policies subject to Section 4232(b) of the New York Insurance Law was the Legislature's response to the "vanishing premium" issues which had occurred in the sale of these types of policies. The failure of the Company to comply with these statutory requirements even after it was brought to its attention only serves to heighten the Department's concerns. In addition, Section 3209 of the New York Insurance Law and Department Regulation No. 74 require that the consumer be provided a copy of a preliminary information statement or in lieu of such statement a sales illustration which complies with Department Regulation No. 74 at or prior to the time of application. The failure to provide the consumer with a copy of the preliminary information statement or in the alternative a sales illustration until the time of policy delivery is again contrary to statutory and regulatory requirements. Section 3209, Sections 3203(a)(15), (16) and (17) of the New York Insurance Law and Department Regulation No. 74 establish the framework for providing basic and timely disclosure to consumers with respect to life insurance products. The timely disclosure of this information is essential in order for the consumer to make an informed decision.

## 7. INTERNAL CONTROLS

A. Paragraph 25 of NAIC Statement of Statutory Accounting Principles ("SSAP") No. 18 of the Accounting Practices and Procedures Manual states the following in relation to the collateral received on loaned securities:

> " . . . The failure by the transferor to maintain sufficient collateral for the loaned securities would result in nonadmission of the undercollateralized portion. The specific collateral requirements are as follows:
> a. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to 102 percent of the fair value of the loaned securities at that date. If at anytime the fair value collateral is less than 100 percent of the fair value of the loaned securities, the counterparty shall be obligated to deliver additional collateral, the fair value of which, together with the fair value of all collateral then held in connection with the transaction at least equals 102 percent of the fair value of the loaned securities."

The collateral requirements noted in SSAP No. 18 above specify that in order to admit the entire portion of its loaned security positions an insurer shall obtain collateral equal to 102 percent of the fair value of loaned securities on the transaction date. The SSAP further requires that the insurer obligate the counterparty to the transaction to deliver additional collateral if the collateral currently being held in connection with the transaction is at any time less than 100 percent of the fair value of the loaned securities, so that the collateral held is restored to a level at least equaling 102 percent.

The Company maintains that it has collateral requirements in place that are more conservative than those indicated by SSAP No. 18, stating that the Company requires collateral of 102 percent of the loaned securities to be maintained at all times, on a cumulative basis by broker.

In response to Specific Risk Analysis questions posed by the examiner at the start of the examination, the Company maintained that it had procedures in place to track the daily market value of securities loaned and collateral held to ensure that any calls for additional collateral are made on a timely basis, minimum collateral levels are maintained, and approved credit limits are not exceeded.

With respect to the review of ongoing maintenance of adequate collateral levels required by SSAP No. 18 and the Company's own internal procedures, the examiner requested that the

Company provide evidence that it had procedures in place for monitoring collateral levels and requesting additional collateral on a timely basis in those instances where the collateralization became inadequate. The Company was able to provide a Broker Collateralization Report dated December 31, 2003, but was unable to provide a Report for any other date during the examination period, as proof that it monitors collateralization on a daily basis. A review of the Report provided revealed six brokers with whom the Company held less than 102 percent collateral, including one broker with whom collateral was held at less than 100 percent. The Company acknowledged that it failed to request additional collateral from the broker with whom collateral was less than 100 percent. Although the Company maintained that it requested additional collateral from the other brokers, the Company failed to provide any documentary proof of timely collateral requests to any of the five remaining brokers collateralized at less than 102 percent. The lack of daily Broker Collateralization Reports combined with the failure to provide evidence of collateral requests to any of the undercollateralized brokers can be indicative of a failure to monitor and maintain adequate collateralization of its loaned security positions on an ongoing basis.

Moreover, the examiner noted, and the Company acknowledged, that the Company's system that automatically prices loans at the suggested fully collateralized price was overridden in certain cases by the Front Office, without any documented explanations. By allowing the system to be overridden by the Front Office without proper verification of the override by Company personnel not involved in the transaction, the Company is not maintaining adequate control over the valuation and collateralization processes. At no time did the Company provide evidence that it maintains documented explanations for such overrides.

With respect to the Company's loaned securities program during the examination period, the failure to maintain daily Broker Collateralization Reports, documented collateral requests for undercollateralized brokers and documented explanations of collateral price overrides are indicative of a lack of adequate internal controls.

B. The Company's Security Lending Inventory provided to the examiners included approximately $5 billion of securities loaned by affiliates or subsidiaries of the Company in addition to the $21 billion that was loaned by the Company. During the review of Schedule D of the filed annual statement the examiner noted that the Company incorrectly used the Leased

Security designation ("LS") in its Schedule D for securities that were not actually leased by the Company. The securities in question, with identical CUSIP numbers to securities held by affiliates or subsidiaries, were actually leased by affiliates or subsidiaries of the Company. This situation was uncovered when a difference of approximately $5 billion was uncovered between the securities listed on Schedule D, Part 1 with an "LS" designation ($26 billion) and the amount ($21 billion) listed on the Company's Securities Lending Inventory that traced to note 16B of the 2003 Annual Statement ($21 billion).

The examiner recommends that the Company correctly designate its leased securities on Schedule D of its filed annual statement.

C. Adequate internal controls require that periodic bank reconciliations be performed, preferably monthly, that reconcile in detail the differences between the Company's general ledger balance and the balance reported to it by the bank. Bank reconciliation detail should be adequate for the purpose of identifying specific reconciling items, e.g., individual checks and deposits. Without identifying specific checks and deposits outstanding independent of information provided by the bank, a bank customer cannot truly know which checks and deposits are legitimately outstanding and which items require further investigation as unexplained discrepancies; and by extension, the bank customer cannot ascertain the true balance on deposit with the banking institution, instead, relying without verification on the bank's information as the correct balance.

By written Examination Request on July 2, 2004, the Company was asked to provide bank reconciliations for a select sample of six bank accounts as part of the review of cash as of December 31, 2003. The Company responded providing documents which it represented as being bank reconciliations, but which provided detail insufficient for the purpose of reconciling the Company's cash accounts to the balances reported by its banks, and in lacking such detail, did not constitute bank reconciliations. When notified of such deficiency, the Company offered to obtain the reconciling detail, but which was obtainable only after considerable computer programming effort on its part. As a process improvement, the Company agreed that "effective Dec. 27th, 2004, [the] check reconciliation [unit] notified the appropriate IT contacts to begin maintaining a monthly listing of outstanding checks beginning with Dec 31, 2004."

The examiner requested that the Company perform reconciliations for a reduced sample of two checking accounts. The Company was ultimately able to reconcile only one of the two accounts but the reconciliation effort required several weeks to complete. At no time was evidence provided to the examiner showing that reconciliations for these checking accounts were performed in a timely manner soon after receiving the bank statement and that they were available for our review upon request.

The Company has "positive pay" accounts with some of its banks. In a positive pay arrangement, the bank customer sends a check issuance file to the bank to authorize payment for the checks itemized within the file. The bank customer should also forward to the bank a file reporting the stopped and voided checks that are contained in the issuance file but should not be paid. The bank in turn sends back a paid check file which the customer should reconcile to its records as a control measure, as well as performing regular periodic reconciliations.

For one positive pay account in which the examiner requested a reconciliation, the Company acknowledged that, based on its own review conducted in April 2004, its records for this account were not matched as they should be to the bank's reported balance. Instead, the Company's check reconciliation unit "established the account in 2001 to match to PayBase," the Company's check fraud avoidance system, "and not the bank's [Proof of] Outstanding." The Company later corrected this as "a decision was made that the reconciliations should [reflect] the bank's outstanding total." Further, the Company admitted that "the bank's Proof of Outstanding did not contain the stops. In order to have the bank statement Proof of Outstanding reflect the correct outstanding check balance, the bank would need a file from MetLife of all the stops from a particular date and prior to be sent ad hoc. The bank would [then] be able to remove the items from their outstanding and the Proof of Outstanding would reflect the correct balance."

Based on the above information from the Company, it is evident that the Company was not performing reconciliations of this account properly and/or failed to notify the bank that its records were not reflecting the stopped or voided checks, resulting in the bank not reporting the proper balance. Further, the failure to provide the bank with a file containing the stopped or voided checks may have caused the bank to pay unauthorized checks. The above failures are indicative of control weaknesses with respect to performing timely and proper bank reconciliations.

While the Company offered to provide individual reconciling items upon request, at no time did the Company provide formal bank reconciliations containing the requisite detail, from the date of the initial Examination Request, July 2, 2004, to the end date of field examination work, October 6, 2005, despite being informed that the bank reconciliations provided to the examiner were inadequate due to the lack of reconciling detail, nor did the Company provide the detail supporting such reconciliations for all of the accounts in question despite being reminded by written Examination Request on January 10, 2005 and in numerous other written and verbal communications. For the positive pay account noted above, the examiner requested a detailed listing of outstanding checks, but the Company failed to provide the listing, despite responding on January 18, 2005 that its target date for providing this listing was January 28, 2005. Further, while the Company maintained that it has bank reconciliation procedures in place, at no point did the Company provide evidence that it actually performed reconciliations, nor did it show evidence of the performance of such procedures in a manner sufficient to constitute a full bank reconciliation for each of the accounts selected for review. Periodic reconciliations performed on a timely basis are a basic control over cash accounts and should be incorporated into the Company's control procedures. Merely being able to reconcile its accounts at a much later date upon request is not assurance that the Company performs its reconciliations in a timely manner.

Without the details as to individual items outstanding within each of the accounts selected for review, the examiner was unable to: test for every account selected the validity of individual reconciling items to determine whether there was actual reconciling detail or merely balancing figures not supported by actual checks, deposits, and other reconciling items; reconstruct whether the Company performed true and timely reconciliations; reconcile all of the Company's cash accounts selected for review, including its primary operating accounts, between the bank balance and the book balance; nor determine whether the cash balances reported in Schedule E of the filed annual statement represented the true balance of each account.

The examiner recommends that the Company maintain documentation sufficient to evidence that it performs periodic cash reconciliations in a timely manner between the general ledger balance and the bank balance for its bank accounts and that such reconciliations include adequate supporting detail.

D. The Company could not reconcile the differences between balances that comprised the Real Estate Managing Agents' amounts reported in Schedule E – Part 1 of the 2003 filed annual statement and the confirmations received by the examiner. The Company has approximately 120 Real Estate Managing Agents' accounts totaling $218,278,848. One account (Property 1071) totaled $222,998,187. According to the Company, its real estate managing agents perform reconciliations to ensure that the information they provide to the Company reconciles to the bank statements. A sample of 15 Real Estate Managing Agents' accounts, including Property 1071, was selected for the Company to reconcile, as part of an Examination Request dated November 16, 2004. In its written response dated December 14, 2004 and updated January 19, 2005, the Company stated that most of the discrepancies were due to timing differences. However, the Company was unable to fully reconcile all the identified differences between balances that comprised the Real Estate Managing Agents' amounts reported in Schedule E – Part 1 of the 2003 filed annual statement and the confirmations received by the examiner. At no time during the course of the examination, from the date of the original Examination Request, November 16, 2004, through the end date of examination field work, October 6, 2005, did the Company provide copies of bank reconciliations performed by its real estate managing agents for 9 of the 15 accounts selected for review, including any for its Property 1071 account, nor did the Company provide evidence that it performs in a timely manner its own periodic reconciliations of these accounts.

Adequate internal controls include performing timely bank reconciliations for cash accounts on a regular basis in order to detect discrepancies and reconcile differences from the bank's reported balance. Due to the nature of cash as an asset, especially cash held in the Company's behalf by an outside party, it is imperative that reconciliations be performed in a timely manner, not merely upon request for review by examiners or auditors, and that such formal timely and periodic reconciliations be documented, maintained, and readily accessible for review.

The examiner recommends that the Company perform timely periodic reconciliations with adequate supporting detail between the Real Estate Managing Agents' accounts listed in Schedule E – Part 1 and the bank balance for its real estate bank accounts and maintain documentation of such reconciliations.

E. The Company certified in their 2003 NAIC Securities Valuation Office ("SVO") Compliance Certification that:

> "1. All securities previously valued by the insurer and identified by a Z suffix have now been submitted to the SVO for a valuation or disposed of by sale or otherwise with the result that all prices and NAIC Designations reported in this statement have been provided by the SVO, except for new purchases identified in Schedule D and DA with a Z suffix or items submitted but not yet processed by the SVO.
> 2. Any newly purchased securities now identified with a Z suffix shall be submitted to the SVO within 120 days of purchase."

The SVO Compliance Certification was signed by an Assistant Vice President of the Company. The Company did not have documented procedures monitoring "Z-Designated" securities in accordance with the procedures prescribed by the NAIC. The "Z" designation is supposed to be used for securities that are filed with the SVO within 120 days of the purchase date and were not rated at year end. However, the Company also used the "Z" designation for securities that were filed with the SVO more than 120 days after the purchase date and for securities that were apparently never filed with the SVO. The Company reported 209 securities with a "Z" designation on Schedule D Part 1 of the 2003 filed annual statement. Of the 209 securities, 140 securities were not filed within 120 days of the purchase date; further, a number of the securities were still listed with a "Z' designation in the 2004 annual statement. In addition, 13 of the 209 securities were rated at December 31, 2003 and should not have been reported with a "Z" designation. The Company misrepresented their certification of compliance with the SVO filing requirements for securities reported with a "Z" designation. The Company could not provide evidence that the securities questioned by the examiner were filed with the SVO within 120 days of the purchase date.

The examiner recommends that the Company comply with the SVO filing requirements in the future with respect to the rating of securities.

F. The Company failed to comply with the annual statement instructions and list all of their custodians in the Investment Section of the General Interrogatories (Question 23.01) of the Company's 2003 filed annual statement. In addition, the Company failed to provide the examiner with a complete listing of custodians in response to the pre-examination letter. It wasn't until the examiner identified $14 billion in discrepancies between the custodian confirmations and Schedule D Part 1 of the 2003 filed annual statement that the Company provided additional custodians for the examiner to confirm. This lead to an extensive delay in confirming the securities listed on Schedule D, Part 1 of the 2003 filed annual statement.

The examiner recommends that the Company provide a complete listing of custodians in response to the aforementioned General Interrogatory question and examiner requests in the future.

G. The Company required almost six months to produce the reinsurance contracts that were entered into during the examination period. It appeared that the Company was unable to locate many of the agreements because of de-centralization; each department maintained the agreements that applied to their department. This caused an extensive delay in the examination of reinsurance.

The examiner recommends that the Company develop a procedure so that, when requested, reinsurance contracts can be provided on a more timely basis.

H. The Company does not have the proper controls in place to ensure compliance with Department Regulation No. 60 and the Company's replacement procedures. There are violations in Section 6A of this report that could have been avoided if the Company had performed periodic reviews of their replacement procedures.

<u>Conclusion</u>

The establishment and implementation of effective, efficient and reliable internal controls and processes are the responsibility of Company management and the board of directors, specifically the committee of independent directors, and should be designed to provide reasonable assurance to achieve the following objectives:

- Effectiveness and efficiency of operations;
- Reliability of financial reporting; and
- Compliance with applicable laws and regulations.

Management should determine through periodic review of the internal control system(s) in place whether control procedures continue to be relevant and are able to address new risks or whether they need to be revised. The ongoing monitoring of internal control systems, including information systems controls, provides assurance that controls continue to operate effectively.

The examiner recommends that the Company develop and implement a plan to improve the Company's system of internal controls in the areas of financial reporting and recordkeeping, information systems, and market conduct (regulatory compliance) to address the aforementioned issues.

## 8. DERIVATIVES OPERATIONS

Required management oversight standards and internal controls for the Company's derivative transactions are documented in the Company's derivative use plan (the "Plan"), which was approved by the Department in January of 2001. The Plan provides that a Chief Hedging Officer ("CHO"), who is a senior manager in the Company's Investment Department, be delegated primary responsibility for risk management and oversight of all derivative activities of the Company. Sections F(2)(b) and F(3)(a) of the Plan specifically assigns the CHO the following responsibilities, respectively:

> " . . . reporting to the Investment Committee of the Board of Directors with respect to derivatives, as set forth in this Plan."

and

> "Before authorizing the entry into Derivative Transactions (including replications) hereunder, the Chief Hedging Officer shall confirm and determine that the Company has . . . (2)adequate professional personnel, technical expertise and systems to implement and control investment practices involving derivatives."

Section F(1)(c) of the Plan further indicates that the CHO (or his designees) will be responsible for the quarterly reports to the Company's board of directors or the investment committee. According to the Plan, these quarterly reports with respect to derivative transaction activity shall include, among other information, "an evaluation of the material risks and benefits of the Derivative Transactions; and other material information to ensure that the internal control procedures are being followed." (Section F(1)(a))

During a significant portion of the examination period, the Company's derivative unit, responsible for the execution and oversight of derivative transactions and activities, was considerably understaffed as highlighted in Department meetings with that unit's personnel. At one point during the examination period, the director of the unit was the only person overseeing these activities as well as performing the primary responsibilities in this area, including the trading of derivatives. Additionally, during this time, the derivative accounting team was insufficiently and unsuitably staffed, requiring significant planned and actual staff additions and firings, and resulting subsequent to the examination period in the dismissal of the head of derivative accounting. This inappropriate staffing of the back office, in particular, contributed to an environment that could, at times, detrimentally impact transactional timeliness and accuracy and the timely confirmation of transactions.

The board of directors failed to review the derivative staff's expertise and was not aware of certain facets of the execution of this function, which resulted in deficiencies and reflected a lack of adequate controls. Such determination was reached after a review of the minutes of the board of directors and investment committee during this period failed to disclose any report or commentary detailing the qualifications and level of performance, or lack thereof, of the staff of the derivative unit and its supporting accounting team. Specifically, the minutes of the meetings of the board of directors did not contain any indication that either the board or the investment committee performed the requisite review that would ensure that all individuals conducting, monitoring, controlling and auditing derivative transactions were suitably qualified and had appropriate levels of knowledge and experience as mandated by Section 1410(b)(3)(A)(ii) of the New York Insurance Law, which states, in part:

> "Prior to entering into any derivative transaction authorized pursuant to this section:
> (A) the board of directors of the insurer or a committee thereof charged with the responsibility for supervising investments shall . . .
> (ii) assure that all individuals conducting, monitoring, controlling and auditing derivative transactions are suitably qualified and have appropriate levels of knowledge and experience . . . "

The Company violated Section 1410(b)(3)(A)(ii) of the New York Insurance Law by failing to have the board of directors, or a committee thereof, assure that all individuals conducting, monitoring, controlling and auditing derivative transactions were suitably qualified and had appropriate levels of knowledge and experience.

Further, assessments of internal controls over derivative transactions performed by Deloitte & Touche LLP ("Deloitte & Touche"), the Company's independent certified public accountant, for the years 2003 and 2004 similarly reported that Deloitte & Touche "was unable to find an indication that the board of directors received a report during the year describing the level of knowledge and experience of individuals conducting, monitoring, controlling and auditing derivative and replication transactions." Section 178.4(c)(4) of Department Regulation No. 163 and the Company's Plan both require that actions shall be taken to correct material deficiencies in internal controls over derivative transactions, "including any deficiencies determined by the Company's independent certified public accountant in its evaluation of accounting procedures and internal controls." Management's response to the exception reported by Deloitte & Touche for 2003 indicated only that "The approval of derivative personnel is delegated to the Chief Hedging Officer under our current Derivative Use Plan. We are discussing these topics with our legal department."

The Company violated Section 178.4(c)(4) of Department Regulation No. 163 as a result of management's failure to take corrective action with respect to the deficiencies noted by the Company's independent certified public accountant in its evaluation of accounting procedures and internal controls over derivative transactions for the years 2003 and 2004.

## 9. PROJECT METRONOME

Project Metronome ("Metronome"), as it is known within the Company, is an investment joint venture between the Company and Barclays Bank Plc ("Barclays"). The purpose behind the Company's investment is twofold: to share in certain tax benefits (group relief payments) accruing to Barclays under U.K. law; and the ability to invest in new offerings of Eurobonds, from which U.S. based entities are precluded (due to Regulation S of the U.S. Securities Law). *Regulation S - Rules Governing Offers and Sales Made Outside the United States Without Registration Under the Securities Act of 1933* states that a U.S. entity is unable to purchase such securities within a 40-day period after the initial offer. Therefore, Project Metronome provides the Company with an opportunity both to participate in global markets and to generate incremental income.

The original investment, approved by the Company's Investment Committee in July 1999, was $2.25 billion. That deal was unwound in 2002, and restructured that year with an upsizing of $2.0 billion, bringing the investment up to $4.25 billion. Another increase of $4.0 billion took place in October 2003, bringing the total investment at the end of 2003 to $8.25 billion. From inception through the end of 2002, the Company realized $77 million of additional after-tax operating income from participation in Metronome. The structure of the entities that are involved in the Metronome transaction are as follows:

1. The two respective owners of Metronome are the Company, and Barclays Bank, who together own St. James Fleet, the investment vehicle at the top of the structure.
2. Barclays owns the common stock and 66% voting control in St. James Fleet and the Company owns preferred stock giving it 34% voting control in St. James Fleet. The Company also owns bonds in St. James Fleet. All of these securities are denominated in British pounds.
3. St. James Fleet in turn owns class B common stock and notes in Park 23 Investments ("Park 23"). 334 Madison, a direct subsidiary of MetLife, owns 99% voting control over Park 23.
4. Park 23 in turn owns Convent Station.
5. Convent Station in turn owns preferred stock in One Madison Investments ("One Madison," also known as "Cayco"). The Company owns 89.9% voting control over One Madison.

The Company's $8.25 billion investment went directly to St. James Fleet, then to Park 23, and then to Convent Station, and finally to One Madison.

The overall effect of the various components of the Metronome structure reported in the annual statement is a wash in which the economic reality is represented primarily by the Company's holdings of foreign fixed income securities through One Madison's investment portfolio, the earnings from that portfolio, and the tax relief payments that the Company shares with Barclays. In the 2003 filed annual statement, the Company recorded an unrealized gain of $1.188 billion due to the appreciation of the British pound against the dollar on its British pound-denominated holdings in St. James Fleet, which was offset by the unrealized loss of $1.188 billion on the forward transfer agreements which require payment in British pounds. The agreed payment under the forward transfer agreements was £5.285 billion. This amount was mirrored by the Company's £1.063 billion investment in St. James Fleet's preferred stock and £4.222 billion in debt owed to the Company.

As noted by examiner, two-thirds of the securities in One Madison's portfolio reflect an average credit quality of A-, which is positioned on the cusp of the upper medium grade and medium grade categories.

Regulatory risk exists in that the Company has not requested the SEC to review this investment to ensure that the Metronome structure does not circumvent Regulation S. There is also regulatory risk with respect to the tax aspects of this joint venture, aspects which may be questioned by the respective tax authorities. Credit risk is represented by the exposure to Eurobonds, many of which are privately-placed securities whose ratings could not be verified by the examiner. The ability of the joint venture to realize the remaining tax benefits was not analyzed during our review, nor was the effect of any of these tax-related changes on the Metronome structure and the related agreements.

The examiner questioned the purchase of Eurobonds by a subsidiary of the Company within a 40-day period after the initial offer, and whether this purchase was in compliance with Regulation S, and asked the Company if there was a legal opinion available on the transaction. The Company provided a legal opinion prepared by McDermott, Will & Emery which opined that the Company could purchase Eurobonds through One Madison. The Company also had an internal legal opinion which indicated that there is no provision of any laws, rules, license requirements or regulations of the United States or New York State which would cause any of the agreements relating to Metronome not to be valid and binding obligations of each of the companies party to the agreement.

The legal opinion given by McDermott, Will & Emery dated October 10, 2002 was based on the Company's statement that One Madison was not formed as a scheme or device to afford the Company the opportunity to invest in securities it would not otherwise be able to purchase for its own account. The Company also stated that there are no agreements, arrangements or understandings between it and One Madison designed to shift investment risk from One Madison to the Company. The Company indicated that One Madison was formed in 1999 and did not begin purchasing Eurobonds until 2002.

Inasmuch as Metronome has enabled the Company to invest in new offerings of Eurobonds from which US entities are normally precluded by Regulation S, the examiner recommends that the Company consider obtaining a legal opinion from the SEC regarding the legality of the Metronome investment and related transactions.

Unwinding of Metronome

According to a series of written agreements, a substantial portion of the Metronome structure is slated to "unwind" in 2017; it may also unwind at any time upon certain conditions, such as a credit decline, an adverse change in law, or upon a mutual decision by Barclays and the Company. Upon the execution of the transfers contained in these agreements, the Company ultimately reacquires the entire legal and beneficial interest in the foreign fixed income portfolio currently held by One Madison. This is accomplished by Convent Station transferring its investment in One Madison to Park 23. In turn, the Company acquires One Madison's preferred shares from Park 23 for the consideration of £5.285 billion specified by the forward transfer agreements. An unwind was successfully tested and executed in May 2002.

<u>Accounting for Metronome</u>

Paragraph 12 of the National Association of Insurance Commissioners Statement of Statutory Accounting Principle ("SSAP") No. 86 of the Accounting Practices and Procedures Manual states, in part:

> "Contracts that do not in their entirety meet the definition of a derivative instrument . . . may contain "embedded" derivative instruments - implicit or explicit terms that affect some or all of the cash flows or the value of other exchanges required by the contract in a manner similar to a derivative instrument. . . . An embedded derivative instrument shall not be separated from the host contract and accounted for separately as a derivative instrument."

The examiner questioned the Company's accounting for the unrealized loss under the forward transfer agreement as that arising under a derivative instrument. The Company held a meeting by teleconference with the examiners for the purpose of discussing a solution to its accounting for the unrealized loss under the forward transfer agreements. The examiners informed the Company that the unrealized loss was not due to derivative instruments and suggested that it change its accounting method to one in compliance with NAIC Statements of Statutory Accounting Principles.

The Company continued to maintain its position citing three criteria under Statement of Financial Accounting Standards ("SFAS") No. 133 which needed to be met in order for the unrealized loss to be recognized as arising from a derivative transaction, according to Financial Accounting Standards. However, a reading of the actual agreement revealed no indication of the existence of a contract that in its entirety meets the definition of a derivative instrument wherein the Company engaged in a forward sale of British pounds. The Company could only accomplish the appearance of meeting the three criteria contained in SFAS No. 133 by dissecting the forward transfer agreements into legally nonexistent parts. The Company summed up its position by stating: "the Forward Transfer Agreement is in effect a combination **similar** (bolding added by examiner) to a circus of a modified total return swap whereby the interest portion is removed by dividending the interest on the underlying investments up to the Company and a foreign currency forward contract with the Company promising to pay, and Park 23 promising to transfer, Cayco's B and C preferred shares for a fixed sterling amount in 2017." The Company's position itself recognizes that the Agreement is 'similar' to, but does not involve any stand-alone derivatives. Instead, the derivative instrument is embedded within the forward transfer agreements.

By recording the unrealized foreign exchange losses on the forward transfer agreements as losses due to derivative instruments, the Company failed to comply with Paragraph 12 of NAIC SSAP No. 86 of the Accounting Practices and Procedures Manual. The examiner recommends that the Company record unrealized losses on the forward transfer agreements as an unrealized foreign exchange capital loss.

The Company responded verbally stating that it would correct its reporting commencing with the 2004 filed annual statement. A review of its 2004 filed annual statement revealed that the Company reported the unrealized loss as a write-in liability amount under the caption 'Forward Transfer Agreement.' Such reporting still does not accurately reflect the true nature of the unrealized loss. The examiner directs the Company to follow the recommendation contained in the preceding paragraph and report such amounts as due to unrealized foreign exchange capital losses. The examiner recommends that the Company take greater care in the preparation of the annual statement to prevent future misclassifications of unrealized foreign exchange capital gains or losses on forward contractual obligations.

In an effort to increase transparency, the examiner recommends that going forward the Company report the details of the Metronome joint venture and related transactions in a note to the annual statement due to the materiality and complexity of the transaction.

## 10. PRIOR REPORT SUMMARY AND CONCLUSIONS

Following is the violation contained in the prior report on examination and the subsequent actions taken by the Company in response to the citation:

| Item | Description |
|---|---|
| A | The Company violated Section 215.17(a) of Department Regulation No. 34 and Section 219.5(a) of Department Regulation No. 34-A when it consistently failed to maintain a specimen copy of each advertisement, and/or a notation indicating its manner and extent of distribution.<br><br>The Company maintains a specimen copy of each advertisement and a notation indicating its manner and extent of distribution. |

## 11. SUMMARY AND CONCLUSIONS

Following are the violations, recommendations and comments contained in this report:

| Item | Description | Page No(s). |
|---|---|---|
| A | Comment that the Company has agreed to withdraw several of its service agreements with affiliates where services are no longer being provided. | 23 |
| B | The Company violated Section 1505(d)(2) of the New York Insurance Law by failing to file six reinsurance treaties with the Superintendent at least 30 days prior to entering into such reinsurance treaties with its affiliates. In addition, the Company has agreed to file the reinsurance treaties still in effect between the Company and its former subsidiaries that have now become sister affiliates. | 23 |
| C | The examiner recommends that the Company report only identifiable claim amounts paid but not reimbursed by the reinsurer on line 13.1 of the annual statement for “Amounts recoverable from reinsurers.” | 29 |
| D | The examiner recommends that the Company revise the four reinsurance agreements with ReliaStar Life Insurance Company so that the insolvency clause complies with Section 1308(a)(2)(A)(i) of the New York Insurance Law. | 29 |
| E | The Company violated Section 125.5(b)(1) of Department Regulation No. 20 for taking reserve credit without obtaining reports from assuming insurers that identified the aggregate of the net amount of reserves plus the liability for any unallocated amounts held by the assuming unauthorized insurers and by each subsequent retrocessionaire on behalf of such reinsurance. | 30 |
| F | In the interest of transparency, the examiner recommends that the Company report the securities lending collateral liability as a separate write-in item clearly identified as such. | 38 |

| Item | Description | Page No(s). |
|---|---|---|
| G | The Department raised concerns with respect to reinvestment risks for the Company's Structured Settlement and Single Premium Immediate Annuity business, due to the prevailing low interest rate environment. The Company addressed these concerns by strengthening related reserves by the amount of $600 million as of December 31, 2004. | 44 |
| H | The Department raised concerns with respect to certain reinsurance agreements for secondary guarantees on universal life insurance. These treaties failed to satisfy the conditions required by Department Regulation No. 102 to be eligible for coinsurance reserve credit; however, these reinsurance agreements remain eligible for yearly renewable term reserve credit. The net effect is disallowance of reserve credit in the amount of $13 million as of December 31, 2003, and in the amount of $43 million as of December 31, 2004. | 44 |
| I | The Department raised concerns regarding the classification of certain guaranteed interest contracts as cash flow matched for computing reserves pursuant to Department Regulation No. 128. The Company has agreed to address these concerns by revising their methodology consistent with the Department's position, which considers the Company's management practices, for calculating such reserves commencing with the December 31, 2005 reserve valuation. | 44 |
| J | The Department raised concerns regarding the lack of conservatism in certain assumptions with respect to the Company's LTC reserves. The Company has agreed to strengthen its LTC reserves, by $450 million. | 44 |
| K | The Company violated Section 51.6(b)(6) of Department Regulation No. 60 by failing to maintain a complete index of replacements. | 46 |
| L | The Company violated Sections 51.6(b)(2), (b)(3) and (b)(6) of Department Regulation No. 60 for: failing to require with or as part of each application a copy of any proposal, including the sales material used in the sale of the proposed annuity contract or life insurance policy, and the proof of receipt by the applicant of the completed Disclosure Statement; failing to maintain any proposals, including the sales material used in the sale of the proposed annuity contract or life insurance policy; and failing to examine any proposal used, including the Disclosure Statement, and ascertain that they were accurate and met the requirements of Department Regulation No. 60. | 48 |

| Item | Description | Page No(s). |
| --- | --- | --- |
| M | The examiner recommends that the Company ensure that its agents identify on the Disclosure Statement whether or not sales material is used in the sale of proposed life insurance policies and annuity contracts. | 49 |
| N | The Company violated Section 51.6(b)(6) of Department Regulation No. 60 and Section 243.2(b) of Department Regulation No. 152 for failing to maintain the notification of replacement to the insurer whose annuity contract was replaced and failing to maintain the documentation received from the replaced insurer that was used to complete the Disclosure Statement for its annuity replacements. | 49 |
| O | The Company violated Section 51.6(b)(4) of Department Regulation No. 60 for failing to furnish to the insurer whose coverage was being replaced a copy of any proposal, including the sales material used in the sale of the proposed annuity contract, and the completed Disclosure Statement within ten days of receipt of the application. | 49 |
| P | The Company violated Section 51.6(e) of Department Regulation No. 60 for failing to furnish changes to their procedures within 30 days of such changes to the Superintendent. | 50 |
| Q | The Company violated Section 3209(b)(1) of the New York Insurance Law and/or Section 53-3.5(a) of Department Regulation No. 74 by failing to provide the applicant with the preliminary information or an illustration, as applicable, prior to or at the time of application for universal life and variable universal life policies. | 52 |
| R | The examiner recommends that the Company review its policy files and identify all such cases where: 1) there is no signed statement by the applicant indicating receipt of the preliminary information or an illustration, as applicable; 2) the signed statement that the applicant received the preliminary information or illustration, as applicable, indicates it was provided after the policy was delivered; and 3) the signed statement that the applicant received the preliminary information or illustration, as applicable, indicates it was provided after the date of the application but prior to or at the time that the policy was delivered. The examiner also recommends that the Company develop and propose a plan of remediation acceptable to the Department which addresses the Company's failure to provide the required disclosure material (i.e., preliminary information or an illustration, as applicable) in a timely manner. | 52 |

| Item | Description | Page No(s). |
|---|---|---|
| S | The examiner recommends that the Company provide to the Department a plan to assure that, in the future, applicants are provided with the required disclosure in a timely manner in compliance with Section 3209 of the New York Insurance Law and Department Regulation No. 74. | 52 |
| T | The Company violated Section 3201(b)(1) of the New York Insurance Law by using three employee enrollment/consent to insurance forms that were not filed with and approved by the Superintendent. | 53 |
| U | The Company violated Section 54.7(b)(4) of Department Regulation No. 77 by having maximum cost of insurance rates stated in its juvenile and small face amount variable universal life policies in excess of those permitted. | 53 |
| V | The examiner recommends that the Company provide endorsements for all juvenile and small face amount policies where the maximum cost of insurance rates stated in the policies are in excess of those permitted by Department Regulation No. 77, for the purpose of reducing such maximum cost of insurance rates to the rates permitted by Department Regulation No. 77. The examiner also recommends that the Company review its small face amount and juvenile policies to determine which policies were charged more than the maximum mortality rates permitted by Department Regulation No. 77 and the amount of the excess, and report the results of the review to the Department, and in addition, provide the Department with the historic experience (deaths and exposures) and the history of cost of insurance rates charges for small face amount, juvenile, and smoker classes. | 54 |
| W | The Company violated Section 3201(b)(1) for using approved annuity contracts in an unapproved manner by issuing such variable annuity contracts without the required cost disclosure regarding its EDCA accounts, as advised by Department Circular Letter No. 33 (1998). | 55 |
| X | The examiner recommends that the Company review its contract files to identify the variable annuity contracts with EDCA accounts in order to provide the cost disclosure required by Department Circular Letter No. 33 (1998) to the affected contractholders. The examiner also recommends that the Company develop a cost disclosure statement to be provided in a timely manner to future contractholders. | 55 |

| Item | Description | Page No(s). |
|---|---|---|
| Y | The Company violated Section 3214(c) of the New York Insurance Law, and is not in compliance with Office of General Counsel Opinion No. 92-46 dated March 17, 1992, by failing to pay interest on death claims using the interest settlement option rate that is in effect on each day from the date of death to the date of payment. | 56 |
| Z | The Company violated Section 3203(a)(16) of the New York Insurance Law by issuing life insurance policies subject to Section 4232(b) of the New York Insurance Law without disclosing that additional amounts are not guaranteed and the insurer has the right to change the amount of interest credited to the policy and the cost of insurance or other expense charges deducted under the policy which may require more premium to be paid than was illustrated or the cash values may be less than those illustrated. | 56 |
| AA | The Company violated Section 3203(a)(15) of the New York Insurance Law by issuing participating cash value policies without disclosing that dividends are not guaranteed and the insurer has the right to change the amount of dividend to be credited to the policy which may result in lower dividend cash values than were illustrated, or, if applicable, require more premiums to be paid than were illustrated. | 57 |
| AB | Comment that the Company's actions or lack of action are an indication that the Company negligently failed to comply with Section 3203 of the New York Insurance Law. | 58 |
| AC | Comment that with respect to the Company's loaned securities program during the examination period, the failure to maintain daily Broker Collateralization Reports, documented collateral requests for undercollateralized brokers and documented explanations of collateral price overrides are indicative of a lack of adequate internal controls. | 60 |
| AD | The examiner recommends that the Company correctly designate its leased securities on Schedule D of its filed annual statement. | 61 |
| AE | The examiner recommends that the Company maintain documentation sufficient to evidence that it performs periodic cash reconciliations in a timely manner between the general ledger balance and the bank balance for its bank accounts and that such reconciliations include adequate supporting detail. | 62 |

| Item | Description | Page No(s). |
|---|---|---|
| AF | The examiner recommends that the Company perform timely periodic reconciliations with adequate supporting detail between the Real Estate Managing Agents' accounts listed in Schedule E – Part 1 and the bank balance for its real estate bank accounts and maintain documentation of such reconciliations. | 65 |
| AG | The examiner recommends that the Company comply with the SVO filing requirements in the future with respect to the rating of securities. | 66 |
| AH | The examiner recommends that the Company provide a complete listing of custodians in response to the custodian General Interrogatory question and examiner requests in the future. | 66 |
| AI | The examiner recommends that the Company develop a procedure so that, when requested, reinsurance contracts will be provided on a more timely basis. | 67 |
| AJ | The examiner recommends that the Company develop and implement a plan to improve the Company's system of internal controls in the areas of financial reporting and recordkeeping, information systems, and market conduct (regulatory compliance). | 67 |
| AK | The Company violated Section 1410(b)(3)(A)(ii) of the New York Insurance Law by failing to have the board of directors, or a committee thereof, assure that all individuals conducting, monitoring, controlling and auditing derivative transactions were suitably qualified and had appropriate levels of knowledge and experience. | 70 |
| AL | The Company violated Section 178.4(c)(4) of Department Regulation No. 163 as a result of management's failure to take corrective action with respect to the deficiencies noted by the Company's independent certified public accountant in its evaluation of accounting procedures and internal controls over derivative transactions for the years 2003 and 2004. | 71 |

| Item | Description | Page No(s). |
|---|---|---|
| AM | Inasmuch as Metronome has enabled the Company to invest in new offerings of Eurobonds from which US entities are normally precluded by Regulation S, the examiner recommends that the Company consider obtaining a legal opinion from the SEC regarding the legality of the Metronome investment and related transactions. | 74 |
| AN | The examiner recommends that the Company record unrealized losses on the forward transfer agreements as an unrealized foreign exchange capital loss. | 76 |
| AO | The examiner recommends that the Company take greater care in the preparation of the annual statement to prevent future misclassifications of unrealized foreign exchange capital gains or losses on forward contractual obligations. | 76 |
| AP | In an effort to increase transparency, the examiner recommends that going forward the Company report the details of the Metronome joint venture and related transactions in a note to the annual statement due to the materiality and complexity of the transaction. | 76 |

Respectfully submitted,

_____________/s/___________
Mark McLeod
Associate Insurance Examiner

STATE OF NEW YORK )
)SS:
COUNTY OF NEW YORK )

Mark McLeod being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.

_____________/s/___________
Mark McLeod

Subscribed and sworn to before me

this__________ day of ____________________

The foregoing report on examination is respectfully submitted:

| | |
|---|---|
| /s/ | /s/ |
| Mark McLeod | Pierre Glover |
| State of New York | State of Nevada |
| Representing Northeastern Zone | Representing Western Zone |

The foregoing report on examination is respectfully submitted:

| | |
|---|---|
| /s/ | /s/ |
| Mark McLeod | Joseph Pires, CFE, CIE |
| State of New York | State of Mississippi |
| Representing Northeastern Zone | Representing Southeastern Zone |

*APPOINTMENT NO. 22129*

## *STATE OF NEW YORK*

# *INSURANCE DEPARTMENT*

*I, GREGORY V. SERIO, Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:*

***MARK MCLEOD***

*as a proper person to examine into the affairs of the*

***METROPOLITAN LIFE INSURANCE COMPANY***

*and to make a report to me in writing of the condition of the said*

***COMPANY***

*with such other information as he shall deem requisite.*

*In Witness Whereof, I have hereunto subscribed by name and affixed the official Seal of the Department at the City of New York*

*this 15th day of January, 2004*

***GREGORY V. SERIO***
*Superintendent of Insurance*

*Superintendent*