

Government of the District of Columbia
Department of Insurance, Securities and Banking



Gennet Purcell
Commissioner

BEFORE THE
INSURANCE COMMISSIONER OF
THE DISTRICT OF COLUMBIA

Re: Report on Examination – **Hungarian Reformed Federation of America** as of December 31, 2008

ORDER

Pursuant to Examination Warrant 2009-4, an Examination of **Hungarian Reformed Federation of America** as of December 31, 2008 has been conducted by the District of Columbia Department of Insurance, Securities and Banking (“the Department”).

It is hereby ordered on this 9th day of December, 2009, that the attached financial condition examination report be adopted and filed as an official record of this Department.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, this Order is considered a final administrative decision and may be appealed pursuant to Section 31-4332 of the D.C. Official Code.

Pursuant to Section 31-1404(d)(1) of the D.C. Official Code, within 30 days of the issuance of the adopted report, the company shall file affidavits executed by each of its directors stating under oath that they have received a copy of the adopted report and related order.

Pursuant to Section 31-1404(e)(1) of the D.C. Official Code, the Department will continue to hold the content of the report as private and confidential information for a period of 10 days from the date of this Order.

A handwritten signature in black ink, appearing to read 'Gennet Purcell', is written over a horizontal line.

Gennet Purcell
Commissioner

GOVERNMENT OF THE DISTRICT OF COLUMBIA

DEPARTMENT OF INSURANCE, SECURITIES AND BANKING



REPORT ON EXAMINATION

HUNGARIAN REFORMED FEDERATION OF AMERICA

AS OF

DECEMBER 31, 2008

NAIC COMPANY CODE 56553

Hungarian Reformed Federation of America

Report on Examination

December 31, 2008

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REPORT ON EXAMINATION OF FINANCIAL CONDITION

Washington, D.C.
October 11, 2010

Honorable Gennet Purcell
Commissioner
Department of Insurance, Securities and Banking
Government of the District of Columbia
810 First Street, NE, Suite 701
Washington, D.C. 20002

Honorable Alfred W. Gross, Commissioner
State Corporation Commission
Bureau of Insurance
Commonwealth of Virginia
Chair, NAIC Financial Condition (E) Committee
PO Box 1157
Richmond, VA 23218

Dear Commissioners:

In accordance with Section 31-5325 of the District of Columbia Official Code, we have examined the financial condition and activities of

Hungarian Reformed Federation of America

(Hereinafter called the Company) at its home office located at 2001 Massachusetts Avenue, NW, Washington, DC 20036, and the following Report on Examination is submitted.

SCOPE OF EXAMINATION

This examination, covering the period from January 1, 2004 to December 31, 2008, including any material transactions and/or events noted occurring subsequent to December 31, 2008, was conducted under the association plan of the National Association of Insurance Commissioners (NAIC) by examiners of the District of Columbia Department of Insurance, Securities and Banking (the Department).

The last examination of the Company was a full scope examination, covering the period from January 1, 2001 to December 31, 2003.

Our examination was conducted in accordance with examination policies and standards established by the District of Columbia Department of Insurance, Securities and Banking and procedures recommended by the NAIC and, accordingly, included such tests of the accounting records and such other procedures as we considered necessary in the circumstances.

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Our examination included a review of the Company's business policies and practices, management and corporate matters, a verification and evaluation of assets and a determination of the existence of liabilities. In addition, our examination included tests to provide reasonable assurance that the Company was in compliance with applicable laws, rules and regulations. In planning and conducting our examination, we gave consideration to the concepts of materiality and risk, and our examination efforts were directed accordingly.

The Company was audited annually by an independent public accounting firm. The firm expressed unqualified opinions on the Company's financial statements for calendar years 2004 through 2008. We placed substantial reliance on the audited financial statements for calendar years 2004 through 2007, and consequently performed only minimal testing for that period. We concentrated our examination efforts on the year ended December 31, 2008. We reviewed the working papers prepared by the independent public accounting firm related to the audit for the year ended December 31, 2008, and directed our efforts to the extent practical to those areas not covered by the firm's audit.

STATUS OF PRIOR EXAMINATION FINDINGS

Our examination included a review to determine the current status of the fifteen recommendations made in our preceding Report on Examination, which covered the period from January 1, 2001 to December 31, 2003.

During our current examination, we repeated two of the fifteen recommendations made in our prior Report on Examination. See the "Comments and Recommendations" section of this report under the caption "Life Reserves" and "Mortgage Loans" for further discussions regarding these recommendations.

HISTORY

General:

The Company was organized on July 5, 1896 at Trenton, New Jersey and was subsequently incorporated by an act of Congress of the United States of America in the District of Columbia on March 2, 1907. The purposes and objectives of the Federation as stated in its charter and By-laws included:

- To maintain and support the social and fraternal culture, heritage, language and religious traditions of Hungarians in America.
- To provide life insurance and other investment opportunities to help secure the financial well being and future of its members and their families.
- To support a home for the aged, known as the Bethlen Home in Ligonier, Pennsylvania.

Capital Stock:

The Company is a fraternal institution that does not issue stock. The policy holders are the owners of the company.

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Dividends to Stockholders:

The Company does not have stockholders. Thus it did not declare or pay any dividends to stockholders during the period under examination.

Management:

The Federation's By-laws were last revised at the quadrennial Convention of its members held September 25-29, 2008. The By-laws provided that the Board of Directors shall administer, effectuate, guide and control the affairs of the Federation in accordance with the By-laws. Directors are elected at the quadrennial Convention and hold office until the next Convention. Unsuccessful candidates receiving the highest number of votes to become a Director shall serve as alternate members of the Board. Alternate members shall fill vacancies of the elected Board of Directors in the order of the highest number of votes received.

The following comprised the Board of Directors as of December 31, 2008:

<u>Name</u>	<u>Principal Occupation</u>
Laszlo Hamos Demarest, NJ	Chairman of the Board President, Hungarian Human Rights Foundation
George Dozsa New Brunswick, NJ	Vice Chair of the Board; Retired Chemist
John K. Morey Youngstown, OH	Vice Chair, Retired payroll administrator
Andras Demeter Mount Prospect, IL	Director Contractor
Joseph Fabri Beaver Falls, PA	Director Retired
Rev. Leslie E. Martin Livingston, NJ	Director Pastor
Rev. Louis Medgyesi Fairport Harbor, OH	Director Pastor
James Szuch Sharon, PA	Director Retired
Rev. Ferenc Varga Brownstown, MI	Director Pastor

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The By-laws provide that the officers of the Company shall consist of a President, a Secretary, and Treasurer. The By-laws were amended at the last convention and were not submitted to the DISB for review. The officers shall be elected by the Board of Directors and shall serve until his/her successor is duly elected and qualified or the officer is removed.

The following were duly elected Officers serving at December 31, 2008:

Leslie Laszlo Megyeri	President
Douglas Alan Eckley	Treasurer
Vera Bjurstrom	Secretary

Committees:

The Company has the following committees and members:

Auditing and Examinations			Administrative (Search)	
John Morey	Chair		George Dozsa	Chair
Andras Demeter			Laszlo Hamos	
Joe Fabri			Rev. Leslie Martin	
John Lipoczky			Rev. Louis Medgyesi	
Finance and Investment			Sales, Marketing and Field Force	
Rev Leslie Martin	Chair		Jim Szuch	Chair
Jim Szuch			Andras Demeter	
Rev. Ferenc Varga			Rev. Louis Medgyesi	
Joe Kovas			George Dozsa	
Mark Roczey			Joe Fabri	
Douglas Alan Eckley			Robert Kovacs	
			Leslie Laszlo Megyeri	
Strategic Planning				
Rev. Leslie Martin	Chair		Fraternal Activities	
George Dozsa			Joe Fabri	Chair
Laszlo Hamos			John Morey	
John Morey			Jim Szuch	
Jim Szuch			Company President	
William B. Puskas, Jr.			Fraternal Coordinators	
Leslie Laszlo Megyeri				
Douglas Alan Eckley			Church and Clergy	
			Rev. Ferenc Varga	Chair
Bethlen Communities Board			Rev. Louis Medgyesi	
George Dozsa			Rev. Leslie Martin	
Joe Fabri			Andras Demeter	
Laszlo Hamos			Jim Szuch	
John Morey			Student Aid	
Jim Szuch			John Morey	Chair

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Rev. Louis Medgyesi		Rev. Ferenc Varga	
Rev. Ferenc Varga		Andras Demeter	

Conflicts of Interest:

Directors and officers of the Company regularly responded to conflict of interest questionnaires. However, the 2008 questionnaires could not be located. Our review of the responses to the questionnaires completed for 2009 disclosed no conflicts that would adversely affect the Company. Furthermore, no additional conflicts of interest were identified during the course of our examination.

Corporate Records:

We reviewed the minutes of the meetings of the stockholders and Board of Directors for the period under examination. Based on our review, it appeared that the minutes documented the Company's significant transactions and events, and that the directors approved those transactions and events. However, approval of the investment decisions and approval by the finance committee were absent for the last quarter of 2008.

AFFILIATED COMPANIES / INTERCOMPANY AGREEMENTS

There are no affiliated companies, and therefore, no intercompany agreements

FIDELITY BOND AND OTHER INSURANCE

The Company has fidelity bond coverage of \$500,000 with a deductible of \$5,000. The fidelity bond meets the minimum coverage recommended by the National Association of Insurance Commissioners.

The Company appears to have adequate insurance coverage for property, building, contents and liability.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Company has a defined pension benefit plan for their employees. The reported plan liability is \$950,313 as of December 31, 2008. The District of Columbia Department of Insurance, Securities and Banking retained an independent pension actuary to conduct a review of the pension liability in association with the financial examination of the Company as of December 31, 2008. The reviewing pension actuary found that the calculation of the pension liability was reasonable as of December 31, 2008 and complied with the pension plan parameters. Also, however, the reviewing actuary found data and calculation errors that offset each other that ultimately reduced the liability by \$9,034. Based on this small overstatement, no financial adjustment is deemed necessary.

STATUTORY DEPOSITS

The District of Columbia Department of Insurance, Securities and Banking does not require the Company to maintain a statutory deposit.

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TERRITORY AND PLAN OF OPERATION

The Company is a Fraternal Benefit Society incorporated by the Congress of the United States in 1907. The Company issues individual certificates on the lives of its members and has a small, closed group of accident and health certificates and annuities still in force. The Company is a fraternal life insurance company, owned by its members, who are the policyholders. The Company writes life insurance on its members primarily in the northeast and mid-west regions of the United States.

Business comes through the lodges of the fraternal. Business originates with the manager of each lodge who is a part-time exclusive agent and solicits the business. Premium collection is on a direct billing basis. The Company writes life insurance on its members primarily in the northeast and mid-west regions of the United States. However, operations are as far west as California and as far south as Florida

As of December 31, 2008, the Federation was licensed in the following jurisdictions:

California	New Jersey
Connecticut	New York
Florida	Ohio
Illinois	Pennsylvania
Indiana	
Michigan	District of Columbia

MARKET CONDUCT

The scope of our examination did not include market conduct procedures, including, but not limited to, market conduct procedures in the following areas:

- Policy Forms
- Fair Underwriting Practices
- Advertising and Sales Materials
- Treatment of Policyholders:
 - Claims Processing (Timeliness)
 - Complaints

REINSURANCE

There was no assumed reinsurance in force at December 31, 2008. The only ceded reinsurance treaty was an excess agreement with Swiss Re Life & Health America, Inc. for individual life and waiver of premium disability insurance. The Federation's retention was \$50,000 as of December 31, 2008. The reinsurer's maximum liability for any one policy was \$100,000 as of December 31, 2008. Certificates with higher face amounts can be reinsured with Swiss Re on a facultative basis. The treaty contained the proper insolvency clause.

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ACTUARIAL REVIEW

As of December 31, 2008, the Company reported “Aggregate reserve for life contracts”, “Liability for Benefits for employees” (i.e. Pension Liability) and an “Asset Valuation Reserve” (AVR) of \$14,150,657, \$950,313 and \$5,241 respectively. The District of Columbia Department of Insurance, Securities and Banking retained an independent actuary to conduct a review of those reserves in association with the financial examination of the Company as of December 31, 2008.

The independent actuary’ findings and conclusion are as follows:

The methodologies were found to be reasonable but the life insurance valuation data was imported incorrectly into the valuation system and there were insignificant errors in missing and maturity age reserve factors and in the calculation of the pension and AVR reserves. No adjustments were required for the pension or AVR reserves but the importing error caused the calculated life reserves to be understated by approximately \$423,200. In correcting this error, the asset adequacy analysis was rerun and the additional actuarial reserve was reduced by \$400,000. Also the Company provided support demonstrating that deficiency reserves were not necessary and that the unearned premium reserve was double counted as it is included in the advanced premium liability. No financial adjustment was recommended as the reserve increases and decreases offset each other. Further discussions on these reserves are in the “Notes” section of this report.

ACCOUNTS AND RECORDS

The Company’s general accounting records consisted of an automated general ledger and various subsidiary ledgers (e.g., cash receipts, cash disbursements). Our review did not disclose any significant deficiencies in these records.

In addition, our examination disclosed that minutes of the Stockholders and Directors did not include the reporting and approval of investments made by the investment committee. This is discussed further in the “Comments and Recommendations” section of this Report, under the caption “Minutes of Stockholders and Directors.”

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FINANCIAL STATEMENTS

The following financial statements reflect the financial condition of the Company as of December 31, 2008, as determined by this examination:

<u>STATEMENT</u>	<u>PAGE</u>
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The accompanying "Note to Financial Statements" is an integral part of these financial statements.

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BALANCE SHEET

ASSETS

	Assets	Nonadmitted Assets	Net Admitted Assets	Examination Adjustment Increase (Decrease)	Net Admitted Assets Per Examination
Bonds	\$8,214,467	0	\$8,214,467	0	\$8,214,467
Preferred Stocks (NOTE 2)	1,876,180		1,876,180		1,876,180
Common stocks (NOTE 2)	3,085,658		3,085,658		3,085,658
Mortgage Loans on real estate (NOTE 5)	1,310,289		1,310,289	(114,874)	1,195,414
Real estate occupied by the Company (NOTE 4)	742,541		742,541	(7,165)	735,376
Real Estate held for sale (NOTE 5)	0			114,874	114,874
Cash (\$73,464), cash equivalents (\$2,126,054) and short term investments (\$0) (NOTE 3)	2,199,518		2,199,518	(16,104)	2,183,414
Contract Loans	165,278		165,28		165,278
Aggregate write in (Bridge Loan) (NOTE 6)	152,301		152,301		152,301
Subtotals, cash and invested assets	\$ 17,746,232	\$ 0	\$ 17,746,232	\$ (23,269)	\$ 17,722,963
Investment income due and accrued	128,924		128,924		128,924
Deferred premiums and agents' balances and installments booked but deferred and not yet due	4,275		4,275		4,275
Current federal and foreign income tax recoverable	0		0		0
Net deferred tax asset	0		0		0
Totals	\$ 17,879,431	\$ 0	\$ 17,879,431	\$ (23,269)	\$ 17,856,162

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LIABILITIES, SURPLUS AND OTHER FUNDS

	Amounts per Annual Statement	Examination Adjustments	Amounts per Examination
Aggregate reserve for life contracts (NOTE 1)	\$ 14,150,657	\$ 0	\$ 14,150,657
Liability for deposit type contracts	12,385		12,385
Contract claims life	199,142		199,142
Premium and annuity considerations received in advance	119,484		119,484
Commissions to field workers due and accrued	2,547		2,547
General Expenses Due and accrued	25,632		25,632
Taxes, licenses and fees	72,000		72,000
Liability for benefits for employees and fieldworkers	950,313		950,313
Asset valuation reserve (NOTE 7)	5,241		5,241
Drafts outstanding (NOTE 3)	<u>16,104</u>	<u>(16,104)</u>	<u>0</u>
Total liabilities	<u>\$ 15,553,505</u>	<u>\$ (16,104)</u>	<u>\$ 15,537,401</u>
Unreconciled difference between Company reports	34		34
Building Repair (NOTE 4)		(7,165)	(7,165)
Surplus as regards policyholders	<u>\$ 2,325,892</u>	<u>\$(7,165)</u>	<u>\$2,318,727</u>
Total liabilities and surplus	<u><u>\$ 17,879,431</u></u>	<u><u>\$ (23,269)</u></u>	<u><u>17,856,162</u></u>

Hungarian Reformed Federation of America
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STATEMENT OF INCOME

<u>Underwriting Income:</u>	
Premiums and annuity considerations for life	\$ 314,993
Net Investment income	1,021,580
Amortization of Interest Maintenance Reserve	(24,621)
Charges and fees for deposit type contracts	4,455
Total	<u>1,316,407</u>
Death Benefits	370,554
Matured endowments	164,560
Surrender benefits and withdrawals for life contracts	211,335
Increase in aggregate reserve for life contracts	(112,222)
Totals	<u>634,227</u>
Commission on Premiums, direct business	28,005
General Insurance expense and fraternal expenses	1,149,661
Insurance taxes, licenses and fees	37,390
Total	<u>1,849,283</u>
Net gain from operations before refund to members (loss)	\$ (532,876)
Net Capital Gains (losses)	(593,874)
Net income (Loss)	<u><u>\$ (1,126,750)</u></u>

Hungarian Reformed Federation of America
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CAPITAL AND SURPLUS ACCOUNT

Surplus as regards policyholders, December 31, 2003	\$ 7,962,441
Net income, 2004 (losses)	\$ (562,258)
Change in net unrealized capital gains or (losses)	47,351
Change in nonadmitted assets	69,245
Change in reserve on account of change in valuation basis	(1,600,000)
Change in asset valuation reserve	40,247
Net change in surplus as regards policyholders, 2004	<u>(2,005,415)</u>
Surplus as regards policyholders, December 31, 2004	\$ 5,957,026
Net income, 2005 (losses)	(574,631)
Change in net unrealized capital gains or (losses)	(133,668)
Change in reserve on account of change in valuation basis	600,000
Change in asset valuation reserve	(299,401)
Net change in surplus as regards policyholders, 2004	<u>(407,700)</u>
Surplus as regards policyholders, December 31, 2005	<u>\$ 5,549,326</u>
Net income, 2006 (losses)	\$ (478,719)
Change in net unrealized capital gains or (losses)	543,152
Change in asset valuation reserve	19,685
Unreconciled difference between Company reports	42
Net change in surplus as regards policyholders, 2006	<u>84,160</u>
Surplus as regards policyholders, December 31, 2006	<u>\$ 5,633,486</u>
Net income, 2007 (losses)	\$ (779,227)
Change in net unrealized capital gains or (losses)	(369,393)
Change in asset valuation reserve	216,401
Aggregate write in for gains and losses in surplus	460
Net change in surplus as regards policyholders, 2007	<u>(931,759)</u>
Surplus as regards policyholders, December 31, 2007	\$ 4,701,727
Net income, 2008 (losses)	\$ (1,126,750)
Change in net unrealized capital gains or (losses)	(1,592,057)
Change in asset valuation reserve	342,926
Unreconciled difference between Company reports	46
Examination adjustments	(7,165)
Net change in surplus as regards policyholders, 2008	<u>(2,399,104)</u>
Surplus as regards policyholders, December 31, 2008	<u>\$ 2,318,727</u>

Hungarian Reformed Federation of America
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ANALYSIS OF EXAMINATION CHANGES TO SURPLUS

Surplus as regards policyholders per Annual Statement, December 31, 2008	\$ 2,325,892
Change in unassigned funds	(7,165)
Surplus as regards policyholders per examination, December 31, 2008	<u>\$ 2,318,727</u>

Hungarian Reformed Federation of America
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COMPARATIVE FINANCIAL POSITION OF THE COMPANY

The comparative financial position of the Company for the five-year period ended December 31, 2008, is as follows:

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Assets	\$17,856,162	\$20,977,723	\$22,141,973	\$22,067,267	\$22,971,167
Liabilities	15,537,401	16,275,996	16,508,487	16,517,946	17,014,141
Policyholders surplus	2,318,727	4,701,727	5,633,486	5,549,320	5,957,026
Premiums income	314,993	358,446	408,515	620,135	643,440
Life Insurance in force 000's	42,922	43,831	43,601	43,939	43,589
Net investment gain (loss)	1,021,580	1,045,853	1,155,482	1,104,543	1,056,839
Net income (loss)	(1,126,750)	(779,227)	(478,719)	(579,733)	(548,052)

Note: Amounts for the years ended December 31, 2004 through 2007 were taken from the Company's Annual Statements as filed with the Department. Amounts for the year ended December 31, 2008 are amounts per examination.

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NOTES TO FINANCIAL STATEMENTS

1. Reserve for Life Contracts:

During our review and testing of the premium data base of the Company; it was disclosed that there were insufficient reserves of \$423,200. The error occurred due to program errors in the data stream transfer. However, counterbalancing errors resulted in no adjustment to the financial statements.

This liability is reported on Page 3, Line 1 and in Exhibit 5 of the Annual Statement. The reserve breakdown in Exhibit 5, by type of benefit, is as follows (difference due to rounding):

	<u>Reported</u>	<u>Adjusted</u>
Life Insurance	\$ 11,790,548	\$ 12,213,574
Annuities	1,144,908	1,144,908
Accidental Death Benefits	13,276	13,543
Disability - Active Lives	2,217	2,213
Disability - Disabled Lives	3,901	3,901
Miscellaneous	<u>1,195,807</u>	<u>772,517</u>
Grand Totals	\$ 14,150,657	\$ 14,150,657

As previously discussed in this report, the aggregate reserve for life certificates and contracts of \$14,150,657, as reported by HRF on Page 3, Line 1 and in Exhibit 5 of the December 31, 2008 Annual Statement appears fairly stated. It has been accepted for the purpose of this report, subject to the recommendations mentioned in the Comments and Recommendations section of this Report. No financial adjustment was necessary as the total reserves remained the same, but were shifted from the miscellaneous to the life section of Exhibit 5.

The reported balance for Life Insurance of \$11,790,548 is a reserve for traditional life insurance certificates including whole life, term and endowments. As further discussed in the "Comments and Recommendations" section of this report, it was determined that the reserves were understated by approximately \$423,200.

The reported balance for Annuities of \$1,144,908 is a reserve for single premium and flexible premium deferred annuities. It was concluded that this reserve appears reasonable.

The reported balances for Accidental Death Benefits, Disability Active and Disability Disabled in the amounts of \$13,276, \$2,217 and \$3,901 are reserves held for supplemental benefits provided under traditional life insurance certificates. It was concluded that these reserves appear reasonable.

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The Miscellaneous reserves are comprised of the following:

	<u>Reported</u>	<u>Adjusted</u>
Deficient premium reserve	\$ 119,295	\$ 119,295
Unearned premiums	76,512	76,512
Additional actuarial reserve	<u>1,000,000</u>	<u>576,712</u>
Total (Net)	\$ 1,195,807	\$ 772,517

The deficiency and unearned premium reserves were verified by the contracted actuary by reviewing the spreadsheet used to calculate the reserves. The methodology and assumptions appeared reasonable. No exceptions were noted. The deficiency reserve was based on a prior interpretation indicating that premiums under five year renewable and convertible term policies were guaranteed during subsequent renewal periods. It was subsequently determined that the rates were not guaranteed and that no deficiency reserve was required. It was also determined that the unearned premium reserve was held in the advanced premium liability as well as in Exhibit 5 of the annual statement. Therefore, both the deficiency and unearned premium reserves could be used to offset the understated traditional life reserves.

As previously discussed, it was determined that reserves were understated by approximately \$423,200. As a result of this correction, the appointed actuary reran the asset adequacy analysis using the corrected reserve data and determined that the required additional asset adequacy reserve could be reduced to \$600,000.

No financial adjustment is recommended as the reserve increases were offset by the decrease in required actuarial reserves.

2. Excess Equity Investments

The Company has equity investments in preferred and common stock at December 31, 2008 that when combined, exceed the amount permitted by District of Columbia Official Code § 31-1372.05 regarding limitations on equity interests. Aggregate amount of investments held by the insurer under this section of the Code exceeds the 20% limitation of its admitted assets. The Company's aggregate amount of investments that are subject to limitation also exceeds the additional investment authority permitted by District of Columbia Official Code § 31-1372.12.

3. Drafts Outstanding

The Company misclassified outstanding checks as outstanding Drafts. This misclassification presented the financials with a drafts outstanding liability and overstated cash by \$16,104. According to Statement of Statutory Accounting Principles (SSAP) No. 2 both negative and positive cash amounts are to be presented together.

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4. Building Repairs

The Company capitalized repairs made to the office building owned and operated by the Company. In accordance with Statement of Statutory Accounting Principles (SSAP) 40 paragraph 14 if an improvement does not extend the life of the asset the improvement should be expensed in the year made. The Company's remaining balance on the heating and air repairs should be expensed.

5. Foreclosed Property

The Company foreclosed on a real estate loan with a balance of \$114,874 on November 27, 2008. The property was included with other loans on the financials. The property should have been presented as a separate line titled 'Property held for sale'. In addition, the property was not shown in Schedule A of the Financials.

6. Unsecured past due loan

The Company has an unsecured loan to a Hungarian organization in New York State as a bridge loan. The loan was to be for \$150,000 in advances so that the NY organization could take advantage of a grant. As of June 30, 2009 the second advance has not been repaid. The loan, plus past due interest of \$2,301, should have been nonadmitted for December 31, 2008 reporting purposes. However, the loan was subsequently repaid on October 1, 2009.

7. Asset Valuation Reserve

The Asset Valuation Reserve (AVR) is a reserve established for all invested asset classes and is designed to minimize the impact of potential equity and credit losses and reflects realized and unrealized capital gains/(losses). During the examination, an independent actuary contracted for this examination reviewed the Company's work papers supporting the reserve and found several errors, including missed realized and unrealized capital gains/(losses), incorrect factors, miscategorized assets, and clerical errors. The contracted actuary recalculated the AVR for years 2006, 2007, and 2008; prior years had a slightly different methodology in the Company's workpapers, and the 2005 AVR had apparently been previously restated. The same error pattern was present for all three years. The reported and recalculated AVRs are as follow.

AVR Annual Statement

<u>Year</u>	<u>Reported</u>	<u>Recalculated</u>
2006	\$ 564,568	\$ 838,462
2007	348,167	564,939
2008	5,241	6,271

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The Company's 2008 corrected AVR consists of a default component of \$6,271 and an equity component of \$0. The 2008 AVR represents a substantial decrease from the corresponding reserve at the end of 2007, primarily the result of substantial capital losses in 2008. Based on this small understatement between the reported and recalculated amounts, no financial adjustment is deemed necessary. However, it is recommended that the Company correct the calculation going forward.

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COMMENTS AND RECOMMENDATIONS

Life Reserves:

As indicated in the NOTE 1 in the “Notes to Financial Statements” section of this Report, the Company reported Aggregate reserve for life contracts as of December 31, 2008 were reviewed as part of our examination by an independent actuary who concluded that these reserves appeared to be sufficient.

In the examination as of December 31, 2008 errors were found which were determined to be caused by a problem importing the data into the valuation system. It was noted that reserves were understated by \$423,200. However, there were redundant reserves which offset the deficiency. No adjustments to the reserves were considered necessary.

It is recommended that future Actuarial Opinion Memorandum include a thorough discussion of the significant risks associated with both assets and liabilities. Identify all liabilities excluded from asset adequacy testing, and discuss the appropriateness of assets associated with such liabilities. In addition the following is recommended:

- **Create and implement controls to insure the correct importing of data into the valuation system.**
- **Correct the maturity age reserve factors.**
- **Correct the data used, e.g. missing factors in the valuation system.**
- **Correct the calculation errors for the pension reserve and the AVR.**

Excess Equity Investments

The Company reported equity investments of \$4,961,838 at December 31, 2008. In accordance with District of Columbia Official Code § 31-1372.05 (b) Equity Investments; “An insurer shall not acquireinvestments held by the insurer this section would exceed 20% of its admitted assets”. In addition, the Company’s aggregate invested assets that are subject to limitations exceeded the additional investment authority permitted by District of Columbia Official Code § 31-1372.12. It was noted that, subsequent to the date of this Report, the Company has taken steps to come into compliance with the statutes regarding investment limitations.

It is recommended that in the future the Company stay in compliance with District of Columbia Official Codes §§ 31-1372.05 and 31-1372.12. In addition, we recommend that the written investment plan of the Company be updated to reflect the District of Columbia Official Codes concerning investment limitations.

Mortgage Loans

A sample of mortgage files was selected to review for documentation of hazard insurance and evidence of property tax payments. In several instances, items in our sample did not contain evidence of the payment of recent property taxes. It should be noted that this condition was also reported in the previous examination.

It is again recommended that the Federation obtain and maintain, for every mortgage in its portfolio, evidence of hazard insurance and current property tax payments.

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The Company foreclosed on a real estate loan for \$114,874 on November 27, 2008. The property was included with other loans on the financial. The property should have been shown as a separate line titled Property held for sale. In addition the property was not shown in Schedule A of the Financial.

It is recommended that the Company follow the instructions for the preparation of the annual statement.

Management Letter Comments

During our examination, in addition to the above Comments and Recommendations, we made other suggestions and recommendations to the Company with regard to record keeping, reporting deficiencies and other procedures relating to its operations in a management letter. These additional suggestions and recommendations were not deemed significant for inclusion in our Report on Examination.

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SUBSEQUENT EVENTS

In August of 2009 the Company sold its home office building to a partnership formed by officers of the Company. The Company received a promissory note with a face value of \$2,800,000 from the partnership in exchange for the building. At the time of the sale, the Company entered into a leaseback agreement with the partnership with an initial term ending December 31, 2013. The sales transaction is in violation of **District of Columbia Official Code § 31-1371.06(a)(3)** which prohibits the Company from entering into an agreement for the sale of property to an officer of the Company without the prior approval of the Commissioner. The promissory note is in violation of **District of Columbia Code § 31-1371.06(a)(1)** which prohibits loans made to officers of the Company without the prior approval of the Commissioner. Accordingly, the Department ordered the transactions surrounding the sale and leaseback of the Company's home office building to be undone.

The Company, with their financial advisors, is in the process of decreasing its equity investments to come into compliance with the **District of Columbia Official Code** regarding investments limitations.

Subsequent to year-end 2008, the Company's financial condition continues to deteriorate. With the filing of the second quarter 2009 financial statements as of June 30, 2009, the Company reported the following underwriting and investment results:

Net loss from operations	\$ (252,479)
Net realized capital losses	\$ <u>(319,037)</u>
Net income	\$ <u><u>(571,516)</u></u>

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CONCLUSION

Our examination disclosed that as of December 31, 2008, the Company had:

Admitted assets	<u>\$ 17,856,162</u>
Liabilities	<u>\$ 15,537,401</u>
Unassigned funds (surplus)	<u>\$ 2,318,727</u>
Total liabilities, capital and surplus	<u>\$ 17,856,162</u>

Based on our examination, the accompanying balance sheet, as adjusted, properly presents the statutory financial position of the Company as of December 31, 2008, and the accompanying statement of income properly presents the statutory results of operations for the period then ended. The supporting financial statements properly present the information prescribed by the District of Columbia Official Code and the National Association of Insurance Commissioners.

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SIGNATURES

In addition to the undersigned, Chidinma Ukairo of the District of Columbia Department of Insurance, Securities and Banking participated in certain phases of this examination:

The actuarial portion of this examination was completed by David J. Macesic, ACAS, MAAA, of INS Consultants, Inc.

Respectfully submitted,



Frank J. Ryan, JR. CPA
Examiner-In-Charge
District of Columbia Department of
Insurance, Securities and Banking

Under the Supervision of:



Nathaniel Kevin Brown. CPA, CFE
Chief Financial Examiner
District of Columbia Department of
Insurance, Securities and Banking