

**REPORT ON EXAMINATION  
OF  
ATLANTIC SOUTHERN INSURANCE COMPANY**

**AS OF**

**DECEMBER 31, 2010**

**NAIC CODE 61158**

**BY THE  
OFFICE OF THE COMMISSIONER OF INSURANCE OF PUERTO RICO**

## TABLE OF CONTENTS

|  |    |
|--|----|
| Scope of Examination .....                       | 2  |
| Summary of Significant Findings .....            | 3  |
| Current Examination Findings .....               | 3  |
| Compliance with Prior Examination Findings ..... | 5  |
| History .....                                    | 5  |
| Capital Stock .....                              | 6  |
| Dividends to Stockholders .....                  | 7  |
| Management and Control .....                     | 7  |
| Investment Plan .....                            | 10 |
| Corporate Governance .....                       | 10 |
| Conflict of Interest .....                       | 11 |
| Corporate Records .....                          | 11 |
| Board of Directors and Committee Minutes .....   | 11 |
| Fidelity Bonds and Other Insurance .....         | 12 |
| Pension and Insurance Plans .....                | 12 |
| Employees' Retirement Plan .....                 | 12 |
| Intercompany Agreements .....                    | 13 |
| Growth of the Company .....                      | 15 |
| Insurance Products and Related Practices .....   | 15 |
| Territory and Plan of Operations .....           | 16 |
| Statutory Deposits .....                         | 16 |
| Unclaimed Funds .....                            | 18 |
| Reinsurance .....                                | 19 |
| Reinsurance Assumed .....                        | 19 |
| Reinsurance Ceded .....                          | 20 |
| Accounts and Records .....                       | 22 |
| Financial Statements .....                       | 24 |
| Subsequent Events .....                          | 31 |
| Summary of Examination Recommendations .....     | 32 |
| Conclusion .....                                 | 36 |



GOVERNMENT OF PUERTO RICO  
OFFICE OF THE INSURANCE COMMISSIONER

December 28, 2011

Mr. Ramón L. Cruz Colón, CPCU, AU, ARe  
Commissioner of Insurance  
Office of the Commissioner of Insurance  
B5 Tabonuco Street - Suite 216  
PMB 356  
Guaynabo, PR 00968-3029

Dear Commissioner:

In compliance with your instructions and pursuant to the Order Number EX-2011-134A dated May 4, 2011, and the Puerto Rico Insurance Laws and Regulations, a comprehensive risk focused examination and financial affairs examination was made of the books, records, and financial condition of

**Atlantic Southern Insurance Company**  
1054 Munoz Rivera  
San Juan, Puerto Rico 00927

hereinafter referred to as ASICO or the Company.

## Scope of Examination

The current examination was conducted at the home office of the Company located at 1054 Muñoz Rivera, Río Piedras, Puerto Rico. This examination covers the period of January 1, 2009 through December 31, 2010, including any material relevant transactions and/or events occurring subsequent to the examination date and noted during the course of the examination.

We conducted our examination in accordance with the *National Association of Insurance Commissioners Financial Condition Examiners Handbook* (Handbook). The Handbook requires that the examination be planned and performed to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and Annual Statement instructions, as applicable to the Puerto Rico Insurance Laws and Regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

## **Summary of Significant Findings**

### **Current Examination Findings**

The following is a summary of material adverse findings, significant non-compliance findings, or material changes in the financial statements noted during the examination.

#### ***Salaries and Compensation, Authorization***

The Board of Directors did not approve salaries in excess of the statutory requirements during the years under examination as required by Article 29.220(1) of the Insurance Code of Puerto Rico.

#### ***Regular Annual Meeting of Stockholders***

The regular annual meeting of the stockholders was not held in 2010. The Company was not in compliance with Article 29.140 (1) of the Insurance Code of Puerto Rico and the bylaws Section 101.

#### ***Special Meetings of the Stockholders***

A special meeting of stockholders was held on December 30, 2010. There was no notice sent to the stockholders. The Company was not in compliance with Article 29.140 (4) of the Insurance Code of Puerto Rico and the bylaws Section 104.

***Regular Annual Meeting of the Board of Directors***

The regular meeting of the Board of Directors was held on May 12, 2010. Notice of the meeting was sent to the Board of Directors on May 11, 2010. The Company was not in compliance with the bylaws Section 206.

***Fidelity Bonds***

The Company did not maintain fidelity bond coverage, or Directors' and Officers' (D&O) coverage as recommended by the Handbook.

***Power to Cede Reinsurance and Normative Letter N-AF- 63-2005***

Article 4.120(1)(b) of the Insurance Code of Puerto Rico and Normative Letter N-AF-63-2005 dated April 11, 2005, require that domestic insurers may only reinsure with unauthorized insurers if prior authorization is obtained from the Office of the Commissioner of Insurance of Puerto Rico.

The Company reinsured with Sirius International Insurance Company, which is not authorized in Puerto Rico. The Company did not obtain prior approval from the Office of the Commissioner of Puerto Rico.

This finding was also noted during the previous examination.

In addition, Schedule S of the 2010 Annual Statement lists the reinsurer as Innovative, instead of Sirius International Insurance Company. Although there are no reinsurance reserves, the Company classifies Innovative as an authorized reinsurer.

### ***Unclaimed Funds***

The Company did not include in the written report to the Commissioner the last known address of six (6) of the insured or beneficiaries entitled to receive the unclaimed funds in 2009. The Company was not in compliance with Article 26.040 (2)(a) of the Insurance Code of Puerto Rico.

### **Compliance with Prior Examination Findings**

The prior examination report was not finalized.

### **History**

The Company was originally incorporated in December 29, 1945, under the provisions of the Insurance Code of Puerto Rico. The Company has been engaged in the underwriting of industrial life insurance, ordinary life insurance, ordinary individual annuities, credit life insurance, group life insurance and accident and health insurance.

The Company is licensed to write business in Puerto Rico, U.S. Virgin Islands, British Virgin Islands, and Anguilla. The Company is no longer licensed in Guam; however, the Company is servicing business that is in runoff and a statutory deposit is maintained.

The Company has been a wholly owned subsidiary of North America Life Insurance Company since November 15, 2001.

### **Capital Stock**

As of December 31, 2010, the Company had 200,000 common stock shares authorized, 131,695 issued and outstanding with a par value of \$20 per share, for paid in capital of \$2,633,900. ASICO is a direct subsidiary of North America Life Insurance Company of Texas, which owns 131,690 of the 131,695 shares outstanding.

The remaining five shares were issued to the following directors in compliance with Article 29.150(1) of the Insurance Code of Puerto Rico:

Clifton Monroe Mitchell  
Alexis González  
Erick Gustavo Negrón  
Antonio José Colorado  
Robert Dixon Tips

### **Dividends to Stockholders**

ASICO's parent, North America Life Insurance Company, has not taken any stockholder dividend over the past five years. The Company was in compliance with the provisions of Article 29.340 of the Insurance Code of Puerto Rico.

### **Management and Control**

The bylaws state that the Board of Directors shall have no less than five (5) or more than nine (9) members who shall be elected at the annual meeting of the stockholders. The Company was in compliance with its own corporate bylaws concerning membership.

Article 29.150 of the Insurance Code of Puerto Rico states that not less than the majority of directors of an insurer shall be residents of, and actually reside in, Puerto Rico. The Company was in compliance with Article 29.150 of the Insurance Code of Puerto Rico.

The Company was not in compliance with the Insurance Code of Puerto Rico and the Company bylaws as noted below:

- **Salaries and Compensation, Authorization**

Article 29.220(1) of the Insurance Code of Puerto Rico requires the Board of Directors to authorize any salary, compensation or emoluments to any

director, officer or employee which in the aggregate exceeds twelve thousand dollars (\$12,000) in any one year. The Board of Directors did not approve salaries in excess of the statutory requirements during the years under examination as required by Article 29.220(1) of the Insurance Code of Puerto Rico.

- **Regular Annual Meeting of Stockholders**

Article 29.140(1) of the Insurance Code of Puerto Rico states “the regular annual meeting of the stockholders or members of an insurer shall be held in any city or town of Puerto Rico, as stated in the bylaws of the insurer.”

The bylaws Section 101 requires the stockholders to meet annually. The regular annual meeting of the stockholders was not held in 2010. The Company was not in compliance with Article 29.140(1) of the Insurance Code of Puerto Rico and the bylaws Section 101.

- **Special Meeting of the Stockholders**

Article 29.140(4) of the Insurance Code of Puerto Rico states “special meetings of stockholders or members may be called upon not less than ten (10) days' notice, as provided in the bylaws.” The bylaws Section 104 requires the stockholders to be given not less than 10 days notice for special meetings. The special meeting of stockholders was held on December 30, 2010. There was no notice sent to the stockholders. The

Company was not in compliance with Article 29.140(4) and the bylaws Section 104.

The Company was not in compliance with the Company bylaws below:

- **Regular annual meeting of Board of Directors of the Company**

Bylaws Section 206 states that the “notice of the place, date and hour of every regular and special meeting ... shall be given to each director at least three days before the meeting.” The regular meeting of the Board of Directors was held on May 12, 2010. Notice of the meeting was sent to the Board of Directors on May 11, 2010. The Company was not in compliance with the bylaws Section 206.

As of the examination date, the directors of the Company were as follows:

| <u>Directors</u>        | <u>Principal Occupation</u> | <u>Resident</u>            |
|-------------------------|-----------------------------|----------------------------|
| Erik Gustavo Negrón     | Lawyer                      | San Juan, Puerto Rico      |
| Antonio José Colorado   | Business Owner              | San Juan, Puerto Rico      |
| Alexis González         | President, ASICO            | Trujillo Alto, Puerto Rico |
| Clifton Monroe Mitchell | Insurance Executive         | Austin, Texas              |
| Robert Dixon Tips       | Business Owner              | San Antonio, Texas         |

The officers of the Company were the following:

|                  |  |
|------------------|--|
| Alexis González  | President and CEO                                      |
| Sonia González   | Secretary  |
| Nayda L. García  | Treasurer and<br>Vice President Finance and Operations |
| Hans H. Dahl     | Actuary  |
| Àngel M. Rivera  | Vice President Marketing                               |
| José A. González | Vice President Systems                                 |

### **Investment Plan**

Article 6.040 of the Insurance Code of Puerto Rico provides, among other things, that the Board of Directors of the insurer shall adopt a written plan to acquire and maintain investments, and to outline their investment practices. The Company adopted a plan of investment, which was approved by the Board of Directors of the Company.

The Company's investment plan established the professional qualifications of the persons who will make routine decisions to ensure their investment competence and ethical conduct in compliance with the provisions of Article 6.040 of the Insurance Code of Puerto Rico.

### **Corporate Governance**

The Board of Directors is responsible for providing general oversight over corporate governance matters, including the development and implementation of the appropriate governance policies and procedures.

The Company is not a publicly traded corporation and, therefore, is not subject to the Sarbanes-Oxley Act of 2002.

### **Conflict of Interest**

The Company requires its directors, officers, and key employees to sign conflict of interest questionnaires concerning items that could have an impact on the way they conduct the Company's business in accordance with Article 29.230 of the Insurance Code of Puerto Rico. A review of the conflict of interest questionnaires revealed that the Company is in compliance.

### **Corporate Records**

The Articles of Incorporation, bylaws and all amendments thereto were reviewed for the period under examination. There were no amendments to the Articles of Incorporation and bylaws during the examination period.

### **Board of Directors and Committee Minutes**

The recorded minutes of the meetings of the shareholders, Board of Directors, and certain internal committees were reviewed for the period under examination. The recorded minutes of the Board of Directors adequately documented its meetings and approval of Company transactions and events in accordance with Chapter 29 of the Insurance Code of Puerto Rico.

The Board of Directors approved the purchases of securities. The purchases of the securities were acquired in compliance with the provisions of the Articles 6.080 and 6.090 of the Insurance Code of Puerto Rico.

The Company's overall investment procedures were in compliance with Article 6.040(2) of the Insurance Code of Puerto Rico.

### **Fidelity Bonds and Other Insurance**

The Company did not maintain fidelity bond coverage, or Directors' and Officers' (D&O) coverage. The Company is a named insured on various other policies providing Commercial Property & Liability, Blanket Property, Windstorm, Hail, Earthquake, Equipment Breakdown, EDP Equipment, Valuable Papers, Accounts Receivable, Employers Liability, Commercial Auto Property and Liability and Commercial Umbrella coverages.

### **Pension and Insurance Plans**

#### **Employees' Retirement Plan**

Until December 31, 2003, the Company sponsored a non-contributory defined benefit pension plan covering substantially all of its employees. The Atlantic Southern Insurance Company Puerto Rico Administrative Employees Retirement Plan was amended to freeze benefit accruals effective December 31, 2003. All

accrued benefits of employees that became participants prior to December 31, 2003, became 100% vested. No new participants are allowed in the plan.

Effective January 1, 2004, the Company implemented a defined contribution pension plan for the benefit of all administrative employees. The employees are allowed to make deferred tax contributions up to 10% of the employee's salary, not to exceed \$9,000. The Company matches contributions up to 3% of the annualized salaries provided the employees have more than one year of employment and contribute at least 6% of their annualized salaries to the plan.

A deferred compensation plan has been established for two officers and one former officer of ASICO. As of December 31, 2010, the accrued liability for the plan was \$656,664.

### **Intercompany Agreements**

The Company has the following written agreements with affiliates.

- Effective January 1, 2006, the Company entered into an agreement with North America Holdings (NAH) under which NAH provides financial consulting services to the Company for an annual fee of \$400,000 payable on a quarterly basis.

- On April 1, 2008, the Company entered into a promissory note with NAH that has been subsequently amended. At December 31, 2010, the amount outstanding was \$625,000. The promissory note bears interest at 7% and the interest is due by NAH on the first day of each month. The entire principal amount and the accrued interest is due on April 1, 2013. As of December 31, 2010, the interest due was \$18,641.

The following agreement was terminated in 2010.

- During 2008, the Company entered into an agreement with North America Life Insurance Company under which the Company provided administration services for North America Life Insurance Company's final expense and pre-need insurance business for \$25 per annum per premium-paying policy and \$12 per annum per paid-up policy inforce at the end of each month. This agreement ended August 31, 2010.

The transactions with affiliates were in conformity with Statement of Statutory Accounting Principles 25 of the *NAIC Accounting Practices and Procedures Manual*.

## Growth of the Company

The following data was obtained from the Annual Statements filed with the OCS:

| Year | Admitted Assets | Liabilities  | Company Capital Stock | Gross Paid Contributed Surplus | Unassigned Surplus |
|------|-----------------|--------------|-----------------------|--------------------------------|--------------------|
| 2010 | \$19,288,586    | \$10,388,373 | \$2,633,900           | \$4,886,514                    | \$1,379,799        |
| 2009 | 19,311,364      | 10,582,502   | 2,633,900             | 4,886,514                      | 1,208,448          |
| 2008 | 18,502,379      | 9,972,543    | 2,633,900             | 4,795,194                      | 1,100,742          |
| 2007 | 18,133,464      | 9,926,227    | 2,633,900             | 4,795,194                      | 778,143            |
| 2006 | 18,004,473      | 9,721,637    | 2,633,900             | 4,795,194                      | 853,742            |

## Insurance Products and Related Practices

The Company is authorized to write life and disability insurance in conformity with Chapter 4 of the Insurance Code of Puerto Rico. For the period covered by this examination, the major kind of insurance and gross premiums written were as follows:

|                 | 2006                | 2007                | 2008                | 2009                | 2010                |
|-----------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Industrial Life | \$15,162            | \$12,021            | \$10,797            | \$8,118             | \$8,152             |
| Ordinary Life   | 1,917,892           | 1,853,975           | 2,014,144           | 2,234,630           | 2,344,627           |
| Life Annuities  | 110,227             | 100,702             | 88,870              | 97,245              | 103,623             |
| Credit Life     | 621,290             | 703,721             | 546,768             | 177,807             | 127,965             |
| Group Life      | 45,388              | 40,145              | 52,610              | 74,697              | 235,162             |
| A&H Group       | 11,132,554          | 12,709,980          | 13,001,264          | 12,999,477          | 12,129,899          |
| A&H Other       | 5,923,093           | 6,580,944           | 6,851,332           | 6,861,128           | 8,409,711           |
| <b>TOTAL</b>    | <b>\$19,765,606</b> | <b>\$22,001,488</b> | <b>\$22,565,785</b> | <b>\$22,453,102</b> | <b>\$23,359,139</b> |

### Territory and Plan of Operations

For the period covered under this examination, the Company was licensed to transact insurance business in the following territories with the corresponding written gross premiums:

|                         | 2006                | 2007                | 2008                | 2009                | 2010                |
|-------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Puerto Rico             | \$6,427,179         | \$7,231,367         | \$7,662,496         | \$7,873,745         | \$6,939,923         |
| US Virgin Islands       | 1,930,899           | 1,757,405           | 1,533,252           | 1,533,594           | 1,298,418           |
| British Virgin Islands  | 9,725,728           | 11,255,067          | 11,727,166          | 11,796,819          | 11,473,497          |
| Anguilla                | 1,551,400           | 1,713,916           | 1,605,277           | 1,242,400           | 1,077,695           |
| Other Caribbean Islands | 130,400             | 43,733              | 37,594              | 6,544               | 2,569,606           |
| <b>TOTAL</b>            | <b>\$19,765,606</b> | <b>\$22,001,488</b> | <b>\$22,565,785</b> | <b>\$22,453,102</b> | <b>\$23,359,139</b> |

### Statutory Deposits

As of December 31, 2010, the Company maintained the following statutory deposits with the OCS in compliance with Article 3.151 of the Insurance Code of Puerto Rico:

| Description                           | Maturity Date | Par Value          | Amortized Value    |
|---------------------------------------|---------------|--------------------|--------------------|
| Puerto Rican Commonwealth - 745145ZC9 | 7/01/21       | \$600,000          | \$570,125          |
| Puerto Rican Electric Power Auth.     | 7/01/37       | 830,000            | 759,957            |
| Puerto Rican Sales Tax Finance Corp.  | 8/01/28       | 1,150,000          | 407,874            |
|                                       |               |                    |                    |
| <b>TOTAL</b>                          |               | <b>\$2,580,000</b> | <b>\$1,737,956</b> |

Article 3.151 of the Insurance Code of Puerto Rico requires that a domestic insurer shall not be authorized to transact insurance in Puerto Rico, unless it deposits and maintains on deposit assets with a value not less than fifty percent (50%) of the amount of the paid-in capital. The deposit is held to protect the Puerto Rico insurance policyholders and creditors.

Article 3.090 of the Insurance Code of Puerto Rico requires the Company to maintain minimum paid-in capital of \$2,500,000 and a statutory deposit of not less than \$1,250,000 of amortized value. The Company was in compliance with Article 3.090 of the Insurance Code of Puerto Rico as of December 31, 2010.

Article 3.160 of the Insurance Code of Puerto Rico requires that 50% of the minimum paid in capital be in Puerto Rico securities. The Company maintained investments in Puerto Rico securities in excess of \$1,250,000 at amortized cost. The Company was in compliance with Article 3.160 of the Insurance Code of Puerto Rico as of December 31, 2010.

Statutory deposits maintained by the Company at December 31, 2010, with other governmental agencies are as follows:

**U.S. Virgin Islands:**

| Description                       | Maturity Date | Par Value | Amortized Value |
|-----------------------------------|---------------|-----------|-----------------|
| CD with First Bank Virgin Islands | 1/28/2011     | \$505,750 | \$505,750       |
| TOTAL                             |               | \$505,750 | \$505,750       |

**British Virgin Islands:**

| Description        | Maturity Date | Par Value | Amortized Value |
|--------------------|---------------|-----------|-----------------|
| CD with Scotiabank | 3/28/2011     | \$586,391 | \$586,391       |
| TOTAL              |               | \$586,391 | \$586,391       |

**Guam:**

| Description      | Maturity Date | Par Value | Amortized Value |
|------------------|---------------|-----------|-----------------|
| CD with ANZ Guam | 1/11/2011     | \$79,262  | \$79,262        |
| TOTAL            |               | \$79,262  | \$79,262        |

**Unclaimed Funds**

The Company complied with Article 26.040 (1) of the Insurance Code of Puerto Rico by reporting unclaimed funds to the OCS, on or before May 1 for the years under examination.

The Company was not in compliance with Article 26.040 (2)(a) of the Insurance Code of Puerto Rico as described next.

- **Unclaimed Funds**

Article 26.040, (2)(a) of the Insurance Code of Puerto Rico requires the “last known address in accordance with the records of the insurer, general agent, manager or authorized representative and the number of the policy or contract.”

The Company did not include in the written report to the Commissioner the last known address of six (6) of the insured or beneficiaries entitled to receive the unclaimed funds in 2009. The Company was not in compliance with Article 26.040 (2)(a) of the Insurance Code of Puerto Rico.

The Company submitted to the OCS the notice of unclaimed funds owed, and the payment of the unclaimed funds and was in compliance with Articles 26.050 and 26.060 of the Insurance Code of Puerto Rico.

## **Reinsurance**

### **Reinsurance Assumed**

The Company assumes 10% of 100% of a quota share reinsurance agreement with National Life Insurance Company. Minimum net retention on any one life of Latin American medical business is \$100,000.

The Company assumes 10% of 100% of a quota share reinsurance agreement with National Life Insurance Company. Minimum net retention on any one life of Caribbean and Latin American Group Life and Personal Accident business is \$100,000.

### **Reinsurance Ceded**

The Company maintains primary treaty reinsurance agreements with Munich Ruckversicherungs-Gesellschaft, Toronto, Canada; Optimum Re Insurance Company, Dallas, Texas; and Hannover Life Reassurance Company, Orlando, Florida. Maximum net retention on any one life for individual and group life insurance products, personal accident products and health insurance products is \$50,000.

The Company ceded to Hannover Life Reassurance Company of America 100% of most of the individual life inforce policies issued prior to October 1, 2001. For policies issued on or after October 1, 2001, the amount of policy cession varied according to the age of the insured and type of risk. The maximum retention on any one policy was \$100,000.

The Company also has an agreement with Optimum Re Insurance Company to retain 35% and 25% of the gross liability arising from the group and individual major medical portfolios, respectively. Under this agreement, the Company

cedes 65% and 75% of the premiums on the group and individual portfolio, respectively. However, from the analysis and examination performed the insurer did not cede more than 75% of its premiums on any individual life of business. In addition, the Company retains a commission on the premiums ceded, ranging from 24% to 28% on the group portfolio and from 28% to 32% on the individual portfolio.

The Company also has other reinsurance agreements covering other life and accident and health products offered by the Company.

The Company periodically evaluates the financial strength of the reinsurers and monitors their financial condition.

The reinsurance contracts reviewed complied with NAIC guidelines with respect to the insolvency clause, arbitration clause, transfer of risk, reporting, and settlement information deadlines as stated in Statement of Statutory Accounting Principles 62 of the *NAIC Accounting Practices and Procedures Manual*.

Article 4.120(1)(b) of the Insurance Code of Puerto Rico and Normative Letter N-AF-63-2005 of April 11, 2005, require that domestic insurers may only reinsure with unauthorized insurers if prior authorization is obtained from the Office of the Commissioner of Insurance of Puerto Rico.

The Company reinsured with Sirius International Insurance Company, which is not authorized in Puerto Rico. The Company did not obtain prior approval from the Office of the Commissioner of Puerto Rico.

This finding was also noted during the previous examination.

In addition, Schedule S of the 2010 Annual Statement lists the reinsurer as Innovative instead of Sirius International Insurance Company and, although there are no reinsurance reserves, the Company classifies Innovative as an authorized reinsurer.

#### **Accounts and Records**

The Company maintained its principal operational offices in San Juan, Puerto Rico where this examination was conducted.

An independent CPA audited the Company's statutory basis financial statements for the year 2010 in compliance with Rule 14-A of the Regulations of the Insurance Code of Puerto Rico. Supporting work papers were prepared by the CPA as required by Rule 14-A of the Regulations of the Insurance Code of Puerto Rico.

The actuarial study and opinion for the period under examination was prepared by Hans H. Dahl, FSA, MAAA, of ARC Consulting, Ltd., Austin, Texas.

## **Financial Statements**

Below are the financial statements of the Company:

- Assets
- Liabilities, Surplus, and Other Funds
- Summary of Operations
- Capital and Surplus Account

Atlantic Southern Insurance Company  
Assets

As of December 31, 2010

|   | Annual<br>Statement  | Examination<br>Adjustments | Examination<br>Balance |
|---|----------------------|----------------------------|------------------------|
| Bonds   | \$ 11,929,387        |                            | \$ 11,929,387          |
| Common stocks   | 250,000              |                            | 250,000                |
| Real estate:  |                      |                            |                        |
| Properties occupied by the company  | 1,398,671            |                            | 1,398,671              |
| Cash and short-term investments   | 2,068,124            |                            | 2,068,124              |
| Contract loans  | 179,544              |                            | 179,544                |
| Other invested assets   | 500,000              |                            | 500,000                |
| Receivables for securities  | 287,656              |                            | 287,656                |
| Investment income due and accrued   | 96,494               |                            | 96,494                 |
| Premiums and considerations:  |                      |                            |                        |
| Uncollected premiums and agents' balances<br>in the course of collection                        | 583,293              |                            | 583,293                |
| Deferred premiums, agents' balances, and<br>installments booked but deferred and not<br>yet due | 398,857              |                            | 398,857                |
| Reinsurance:  |                      |                            |                        |
| Amounts recoverable from reinsurers   | 785,062              |                            | 785,062                |
| Other amounts receivable under reinsurance<br>contracts   | 113,869              |                            | 113,869                |
| Electronic data processing equipment and<br>software  | 13,374               |                            | 13,374                 |
| Receivables from parent, subsidiaries and<br>affiliates   | 18,641               |                            | 18,641                 |
| Aggregate write-ins for other than invested<br>assets   | 665,614              |                            | 665,614                |
| Total Assets  | <u>\$ 19,288,586</u> |                            | <u>\$ 19,288,586</u>   |

**Atlantic Southern Insurance Company**  
**Liabilities, Surplus and Other Funds**

As of December 31, 2010

|  | Annual<br>Statement  | Examination<br>Adjustments | Examination<br>Balance |
|--|----------------------|----------------------------|------------------------|
| Aggregate reserve for life contracts   | \$ 4,949,002         |                            | \$ 4,949,002           |
| Aggregate reserve for accident and health contracts                                      | 191,537              |                            | 191,537                |
| Contract claims:   |                      |                            |                        |
| Life   | 130,679              |                            | 130,679                |
| Accident and health  | 1,451,000            |                            | 1,451,000              |
| Premiums and annuity considerations for life and accident and health received in advance | 141,979              |                            | 141,979                |
| Contract liabilities not included elsewhere:   |                      |                            |                        |
| Other amounts payable on reinsurance   | 721,672              |                            | 721,672                |
| Interest maintenance reserve   | 63,912               |                            | 63,912                 |
| Commissions to agents due or accrued - life and annuity contracts                        | 110,184              |                            | 110,184                |
| General expenses due or accrued  | 313,768              |                            | 313,768                |
| Taxes, licenses and fees due or accrued  | 35,270               |                            | 35,270                 |
| Unearned investment income   | 6,147                |                            | 6,147                  |
| Amounts withheld or retained by company as agent or trustee                              | 219,625              |                            | 219,625                |
| Remittances and items not allocated  | 38,840               |                            | 38,840                 |
| Liability for benefits for employees and agents  | 1,269,281            |                            | 1,269,281              |
| Asset valuation reserve  | 215,336              |                            | 215,336                |
| Aggregate write-ins for liabilities  | 530,141              |                            | 530,141                |
| <b>Total Liabilities</b>   | <b>\$ 10,388,373</b> |                            | <b>\$ 10,388,373</b>   |
| Common capital stock   | \$ 2,633,900         |                            | \$ 2,633,900           |
| Gross paid in and contributed surplus  | 4,886,514            |                            | 4,886,514              |
| Unassigned funds (surplus)   | 1,379,799            |                            | 1,379,799              |
| <b>Total Surplus</b>   | <b>\$ 8,900,213</b>  |                            | <b>\$ 8,900,213</b>    |
| <b>Total Liabilities and Surplus</b>   | <b>\$ 19,288,586</b> |                            | <b>\$ 19,288,586</b>   |

Atlantic Southern Insurance Company  
Summary of Operations

As of December 31, 2010

|   |              |
|---|--------------|
| Premiums and annuity considerations for life and accident and health contracts  | \$13,173,624 |
| Net investment income   | 820,838      |
| Amortization of interest maintenance reserve                                    | 57,019       |
| Commissions and expense allowances on reinsurance ceded                         | 2,307,793    |
| Aggregate write-ins for miscellaneous income                                    | 312,930      |
| Total   | \$16,672,204 |
| Death benefits  | \$417,993    |
| Matured endowments  | 17,381       |
| Annuity benefits  | 193,022      |
| Disability benefits and benefits under accident and health contracts            | 7,626,077    |
| Surrender benefits and withdrawals for life contracts                           | 105,032      |
| Increase in aggregate reserves for life and accident and health contracts       | 300,519      |
| Total   | \$8,660,024  |
| Commissions on premiums, annuity considerations and deposit-type contract funds | 2,807,719    |
| General insurance expense   | 4,674,491    |
| Insurance taxes, licenses and fees  | 405,085      |
| Increase in loading on deferred and uncollected premiums                        | (109,548)    |
| Total   | \$16,437,771 |
| Net gain from operations  | 234,433      |
| Dividends to policyholders  | 52,320       |
| Federal and foreign income taxes incurred                                       | 182,113      |
| Net realized capital loss   | (10,900)     |
| Net (Loss)/Income   | \$ 171,213   |

Atlantic Southern Insurance Company  
**Capital and Surplus Account**

As of December 31, 2010

|   |                           |
|---|---------------------------|
| Capital and surplus, December 31, prior year                  | <u>\$8,728,862</u>        |
| Net (Loss)/Income   | \$171,213                 |
| Change in liability for reinsurance in unauthorized companies | (17,384)                  |
| Change in asset valuation reserve                             | (28,837)                  |
| Aggregate write-ins for gains and losses in surplus           | 46,359                    |
| Net change in capital and surplus for the year                | <u>\$171,351</u>          |
| Capital and surplus, December 31, current year                | <u><u>\$8,900,213</u></u> |

Atlantic Southern Insurance Company  
**RECONCILIATION OF CAPITAL and SURPLUS ACCOUNT**

As of December 31, 2010

The following is a reconciliation of Surplus as regards policyholders between that reported by the Company and as determined by the examination.

|  |             |
|--|-------------|
| Capital and Surplus Account<br>December 31, 2010, per Annual Statement | \$8,900,213 |
|--|-------------|

|   | <u>PER<br/>COMPANY</u> | <u>PER<br/>EXAM</u> | <u>INCREASE<br/>(DECREASE)<br/>IN SURPLUS</u> |
|---|------------------------|---------------------|---|
| ASSETS:   |                        |                     |   |
| No Adjustment   |                        |                     |   |
| LIABILITIES:  |                        |                     |   |
| No Adjustment   |                        |                     |   |
| Net Change in Surplus:  |                        |                     | 0   |
| Capital and Surplus Account<br>December 31, 2010, Per Examination |                        |                     | \$8,900,213                                   |

## Comments on the Financial Statements

**Aggregate Reserve for Life Contracts**

**Aggregate Reserve for Accident and Health Contracts**

**Contract Claims: Life**

**Contract Claims: Accident and Health**

**Uncollected Premiums and Agents' Balances in Course of Collection**

**Deferred Premiums, Agents' Balances, and Installments Booked but Deferred and Not Yet Due**

An independent review of aggregate reserves was performed.

Reserves were reviewed for compliance with standard valuation laws, applicable National Association of Insurance Commissioners Actuarial Guidelines, and Model Regulations.

Sample contracts were selected from the valuation systems for reserve testing based on the residual risk assessments. In choosing samples, it was focused on the products and contracts having provisions identified as having specific risks, thus emphasizing the added risk associated with the contracts tested.

As part of the examination, ASICO's valuation runs and prepares supporting work papers for the reserves reported in the Annual Statement Exhibit 5 which were reviewed. There were no discrepancies between net reserves shown in the valuation files and the net reserves reported in the Annual Statements. Trend

analyses were performed for each reserve item in Exhibit 5. The overall results appeared reasonable.

The primary risks associated with Exhibit 5 businesses are adverse mortality, asset default, interest rate volatility, and mismatching of asset and liability cash flows. These risks were further reviewed by evaluating the 2010 the Actuarial Opinion Memorandum. Based on that review, the Office accepted ASICO's conclusion that additional reserves are not required.

The balance sheet items enumerated in the examination scope appear to be calculated using valuation parameters, which appear to be free of any material error, and valuation files that appear to be complete. Based on the above discussion and analysis, it was has concluded that the December 31, 2010, balance sheet items covered in the examination scope appear fairly stated subject to the recommendations in their report. The balance sheet items have been accepted for the purpose of this report.

### **Subsequent Events**

The Company was recently licensed to transact business in Costa Rica.

During the first quarter of 2011, the Company lost one large account that comprised 36% of the Company's total premium for 2010.

## **Summary of Examination Recommendations**

### ***Salaries and Compensation, Authorization***

The Board of Directors did not approve salaries in excess of the statutory requirements during the years under examination as required by Article 29.220(1) of the Insurance Code of Puerto Rico.

**We recommend the Company comply with Article 29.220 of the Insurance Code of Puerto Rico.**

### ***Regular Annual Meeting of Stockholders***

The regular annual meeting of the stockholders was not held in 2010. The Company was not in compliance with Article 29.140 (1) of the Insurance Code of Puerto Rico and the bylaws Section 101.

**We recommend the Company comply with Article 29.140 (1) of the Insurance Code of Puerto Rico and the Company's bylaws Section 101.**

### ***Special Meetings of the Stockholders***

The special meeting of stockholders was held on December 30, 2010. There was no notice sent to the stockholders. The Company was not in compliance with Article 29.140 (4) of the Insurance Code of Puerto Rico and the bylaws Section 104.

**We recommend the Company comply with Article 29.140 (4) of the Insurance Code of Puerto Rico and the Company's bylaws Section 104.**

***Regular Annual Meeting of Board of Directors of the Company***

The regular meeting of the Board of Directors was held on May 12, 2010. Notice of the meeting was sent to the Board of Directors on May 11, 2010. The Company was not in compliance with the bylaws Section 206.

**We recommend the Company comply with the Company's bylaws Section 206.**

***Fidelity Bonds***

The Company did not maintain fidelity bond coverage, or Directors' and Officers' (D&O) coverage as recommended by the Handbook.

**We recommend the Company obtain fidelity bond coverage as recommended by the Handbook.**

***Power to Cede Reinsurance and Normative Letter N-AF- 63-2005***

Article 4.120(1)(b) of the Insurance Code of Puerto Rico and Normative Letter N-AF- 63-2005 dated April 11, 2005, require that domestic insurers may only reinsure with unauthorized insurers if prior authorization is obtained from the Office of the Commissioner of Insurance of Puerto Rico.

The Company reinsured with Sirius International Insurance Company, which is not authorized in Puerto Rico. The Company did not obtain prior approval from the Office of the Commissioner of Puerto Rico.

This finding was also noted during the previous examination.

In addition, Schedule S of the 2010 Annual Statement lists the reinsurer as Innovative, instead of Sirius International Insurance Company. Although there are no reinsurance reserves, the Company classifies Innovative as an authorized reinsurer.

**We recommend the Company obtain permission from the OCS before placing reinsurance with an unauthorized reinsurer.**

**We recommend the Company identify all reinsurers by the correct name of each company and classify unauthorized reinsurers correctly in Schedule S of the Annual Statement.**

#### ***Unclaimed Funds***

The Company did not include in the written report to the Commissioner the last known address of six (6) of the insureds or beneficiaries entitled to receive the

unclaimed funds in 2009. The Company was not in compliance with Article 26.040 (2)(a) of the Insurance Code of Puerto Rico.

**We recommend the Company comply with Article 26.040 of the Insurance Code of Puerto Rico.**

### Conclusion

The insurance examination practices and procedures as promulgated by the NAIC have been followed in ascertaining the financial condition of **Atlantic Southern Insurance Company** as of December 31, 2010, consistent with the insurance laws of Puerto Rico.

In addition to the undersigned, Charles McMorrow, CFE, CPCU, CIA, CPA, Staff Examiner; and Patricia Casey Davis, CPA, CFE, Manager, both of INSRIS-PR, LLC; Claude Granese, CPA, Senior Manager of INS Services, Inc.; Frank Edwards, ASA, MAAA, Actuary, INS Consultants, Inc.; and Carmelo Hernández Alicea, Supervising Examiner, Office of the Commissioner of Insurance of Puerto Rico, participated in the examination.



Don Gaskill, CFE  
Examiner-in-Charge