STATE OF UTAH INSURANCE DEPARTMENT

REPORT OF LIMITED SCOPE EXAMINATION

of

**NATIONAL ANNUITY COMPANY**

of

Camarillo, California

as of

September 30, 2006

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Filed
Utah State
Insurance Dept.

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February 21, 2007

Honorable D. Kent Michie
Insurance Commissioner
State of Utah
3110 State Office Building
Salt Lake City, UT 84114

Commissioner:

Pursuant to your instructions and in compliance with statutory requirements, a limited scope examination, as of September 30, 2006, has been made of:

NATIONAL ANNUITY COMPANY
Camarillo, California

hereinafter referred to in this report as the Company, and the following report of examination is respectfully submitted.

## SCOPE OF EXAMINATION

### Period Covered by Examination

The current examination covers the period from the Company's inception date of October 27, 2004, through September 30, 2006. A limited-scope examination was performed in accordance with the National Association of Insurance Commissioners (NAIC), Financial Condition Examiners Handbook and the directives prescribed by the Utah Insurance Department (Department).

### Examination Procedure Employed

A limited scope examination is not intended to communicate all matters of importance for the understanding of the Company's financial condition. The procedures employed in this examination have been tailored to address only a review of certain specific financial areas and related operations as of September 30, 2006, and subsequent events. The examination was performed using a "risk focused" approach.

The examination performed certain procedures to verify invested assets including bonds, preferred stocks, common stocks and cash as reported on the most recent quarterly statement as of September 30, 2006, are owned and controlled by the Company. Confirmations of cash and other invested assets were obtained from the custodians and the Company's reconciliations with bank statements were reviewed.

The review included verification of mortgage loans on real estate and other invested assets including ownership, valuation, admissibility and status subsequent to September 30, 2006.

The examination obtained copies of the mortgage management investment agreement, actuarial opinion as of December 31, 2005, and the actuarial valuation as of September 30, 2006. The examination reviewed these items to verify that the Company's operations and the related financial items were in compliance with the requirements of the Department. The examination has not performed any further work on these items.

A review of the minutes of the meetings of the board of directors and shareholders was conducted to determine that appropriate oversight of the Company is being exercised. During the course of the examination, issues relating to the Company's operations were also reviewed.

## SUMMARY OF EXAMINATION FINDINGS

### Management

The Company's 3rd Quarter Statement filing identified in the Jurat page five members of the board of directors (the board). The examination determined that only two of the five directors were residents of the state of Utah. Pursuant to Utah Code Annotated (U.C.A) § 31A-5-406, the Company is not in compliance with this requirement since the current number of directors residing in Utah does not constitute a majority of the board.

Ross Elliot and Clark Parkinson (audit committee chair), Utah residents, were no longer reported on the Jurat page as members of the board as of December 31, 2005. Minutes from the October 6, 2005 board meeting list these two "knowledgeable" board members as a significant reason why the Company will be successful. During the Nov. 22, 2005 board meeting board members Ross Elliott and Clark Parkinson presented a proposal for re-organization to move the Company's offices to Utah and have Ross Elliott replace Dennis Derr as President, with Clark Parkinson replacing Dennis Derr as Chairman of the Board. In the new organization chart, Dennis Derr would still have a controlling ownership interest, and would assume the daily capacity as marketing director. Mr. Elliot explained that this arrangement could be done on a one year trial basis and that their objective was not to diminish Dennis Derr's power in the company, but to bring to bear their significant insurance experience to make a stronger company. The hierarchy of shareholder over board and board over management was explained.

Mike Derr, a board member and blood relation to Dennis Derr expressed his concern that this was Dennis's company and that this would diminish his role, and be a step backwards for the Company. Despite these reservations and some expressed by Dennis Derr himself, including a reference to his securities license being helpful in filings with the SVO, an agreement was reached and the board voted unanimously to the organizational changes for a one year trial period effective January 1, 2006. However, shortly after this

board decision agreeing to the organizational changes, both Ross Elliot and Clark Parkinson had resigned from the board.

Based on management's own board reports, the valuable experience of these board members was an important part of the Company's hopes for future success. In the board minutes themselves and the findings of this examination numerous lapses of management control, adequate board oversight, and compliance failures are due in no small part to a significant lack of adequate management resources and experience.

The Company's legal counsel made representations in a letter to the Department dated May 10, 2004, that the Company intended to relocate its administrative office to Utah and hire Utah residents to run the Salt Lake office. This has not occurred.

Subsequent to the examination date, the two remaining Utah resident members of the board resigned. Dennis Theo Larson and Randall Smart, (who was newly appointed during 2006), notified the Department they would no longer serve on the board as of December 31, 2006. Since this date the Company has not had any Utah resident board members or any outside independent directors. The Department recommends that the Company appoint four additional board members who are residents of the state of Utah.

The Department noted regulatory violations and suspensions with the Company President, Dennis Derr. These violations by the president combined with a pattern of non-compliance with the Utah Insurance Code by the Company while under the direction of the President are a significant risk factor. Although these "tone at the top" considerations may be considered subjective criteria in an overall assessment of the Company's risk profile, they cannot be ignored in this "risk focused" exam, and will be briefly discussed as follows:

On December 24, 2002, prior to the examination period, a "Desist and Refrain Order" was issued by the state of California Corporations Commission. Mr. Derr was ordered to desist and refrain from the offer or sale of investment instruments in the form of promissory notes, real estate investment agreements and/or investment contracts that are in violation of section **26110** of the California Corporate Securities Law of 1968, for not first being qualified. He was not licensed in the State of California at that time, and therefore, ordered to desist and refrain from offering, selling, buying or offering to buy any security in the state of California.

The National Association of Securities Dealers, Inc. (NASD) suspended Mr. Derr from selling securities for two years beginning on March 20, 2006 through March 19, 2008. During this time Mr. Derr is not allowed to associate with an NASD member in any capacity. Mr. Derr submitted a Letter of Acceptance, Waiver and Consent in which he was fined $5,000. He was ordered to disgorge commissions in the amount of $90,240, plus interest, to public customers. Without admitting or denying the finding, Mr. Derr consented to the described sanction and to the entry of findings that he participated in private securities transactions, for commission, without providing prior written or oral notification to, and receiving prior written approval from, his member firm.

In addition, the examination noted some internal control weaknesses with the management of the Company and Dennis Derr. During the examination period covered, the board exercised its oversight responsibilities by reviewing activities of the Company on a quarterly basis at its quarterly meetings. In general investments were approved by the board. One example of a control weakness involved related party transactions.

In the November 22, 2005 board meeting minutes, Randy Smart, attending the board meeting while in his capacity as outside legal counsel, expressed concern regarding investment transactions which had not been approved by the board or by the Department as required by law. These transactions involved commissions being paid to Dennis Derr for certain investment transactions on behalf of the Company. Because these are related party transactions they must be fair to the Company and must be reported to the Department prior to the consummation each individual transaction. Mr. Smart stated that all prior and any future transactions must be reported to Department. Board member Dennis Larsen stated that he could not explain these transactions to the Department because he didn't understand them and had not approved them.

Dennis Derr sent a general disclosure letter to the Department dated December 6, 2005. The letter states in part that "if any board member or officer of the company would receive a fee or commission, they would have their compensation adjusted, which the company is doing with me." This general disclosure letter did not relieve the Company of the responsibility to report the details of each transaction to the Department. Mr. Derr's statement in the letter that this is what "the company is doing with me" is contradicted by the board minutes. The November 22, 2005 board minutes discuss the possibility of such a salary adjusting arrangement, with Randy Smart commenting that it would be too cumbersome and time consuming to administer.

There is no evidence in the minutes of the meetings that persons authorized as signatories were approved, except for a consent of the board approving signers on the Western National Trust Company (Zions Bank – Special deposit). The fact that custodial agreements should be executed was discussed on more than one occasion with Mr. Derr, during the board meetings, yet no action was taken during the examination period to execute the agreements. Subsequent to the examination field work, per the January 15, 2007 board meeting minutes, the board agreed to move investments into custodial agreements with UBS Financial Services and Zion's Custodial Trust Service.

The audit committee was formed on October 6, 2005, with Clark T. Parkinson, a Utah resident, as the audit chairman. As noted previously, Mr. Parkinson was no longer reported as a member of the board as of December 31, 2005. The investment committee, executive committee and compensation committees were also formed on October 6, 2005. The minutes did not specifically identify members of committees, term limits, or committee charter responsibilities. No conflict of interest policy was discussed or approved in the minutes of the meetings of the board.

Board meeting minutes were not signed to evidence that they were entered into the records of the Company. The Department recommends the Secretary sign the board meeting minutes and the board approve them in its next scheduled meeting to improve its internal control process. A conflict of interest policy should be established to improve the governance process, and members of the board should sign affidavits to disclose any conflicts of interest on an annual basis.

The confirmation of assets held with Cornerstone Realty Fund, LLC (Cornerstone) identified Dennis Derr as both the registered name (on behalf of the Company) and the registered representative (on behalf of the broker/dealer Grant Bettingen Inc.) on the statement. Since Mr. Derr's license was suspended, and he cannot associate with any NASD member, the Department notified Cornerstone of this discrepancy.

Transactions with Affiliates

The Company entered a Mortgage Investment Management Agreement (Agreement), effective July 5, 2006, by and between the Company, Integrated Equity Management Corporation (IEMC) and O'Moore Capital, LLC (OMC). The agreement specifies that IEMC shall arrange for loan origination or acquire mortgages for the Company. The agreement also states that OMC is to manage funds for the Company. The examination reviewed the agreement arrangement and operation between IEMC and the Company. (See disclosure titled **Mortgage loans on real estate.)** The examination noted and discussed with the Company the arrangement with OMC on managing funds, and through corroborative inquiry of the President, the examination was informed OMC no longer managed funds according to the agreement. Instead, the Company transfers funds into one of its Midland State Bank accounts, which is used as a checking account for mortgages. The Company set up the manager of IEMC to withdrawn funds from that bank account to pay for the mortgages. (See disclosure regarding signatories under **Cash, cash equivalents, and short-term investments**.) There was no discussion in the board meeting minutes of the informal changes to the Agreement.

In addition, the examination noted the Agreement specifies a loan to value ratio will be 65% or lower based on the appraisal. As of September 30, 2006, 3 of the 10 mortgage loans reported exceeded the 65% limitation. The examination noted that none of the 10 mortgage loans exceeded the 80% limitation noted in U.C.A. § 31A-18-106(2)(b)(i)(A).

The Department recommends the Company amend this agreement to exclude or modify the language regarding OMC's managing of funds. It is recommended the Company revise the loan structure on these 3 mortgage loans or modify the agreement to be consistent with the mortgage loans issued or modify the agreement with the 80% limitation required in U.C.A. § 31A-18-106(2)(b)(i)(A).

During the course of the examination, it was noted the Company did not file its Form B Holding Company Registration Statement by May 1, 2006, as required by U.C.A. § 31A-16-105. The Department's Financial Analyst notified the Company the filing was past due, and the Company filed it in June 2006.

Invested Assets

| | |
|---|---|
| **Bonds** | **$0** |
| **Preferred stocks** | **$0** |

As of September 30, 2006, the Company's 3rd Quarterly Statement reported bonds of $7,409,900 and preferred stocks of $3,339,509. As of this date, the Company maintained three brokerage firm accounts which contained invested securities. Subsequently, the Company closed one of these accounts. The Company did not have a custodial agreement with the second brokerage firm, UBS Financial Services, pursuant to Utah Administrative Code (U.A.C.) Rule R590-178. The third brokerage firm account with Grant Bettingen Inc. (also referenced as Penson Financial Services), was not a qualified custodian as described in U.A.C. Rule R590-178-3(C)(3), since its tangible net worth was not equal to or greater than $250,000,000. It also had no custodial agreement in place.

Pursuant to U.C.A. § 31A-8-211(1), the Company maintained a statutory deposit of $425,255 in U.S. obligations, government agencies and a short-term investment fund. These securities were deposited through a tri-party agreement with Western National Trust Company, an affiliate of Zions Bank. The Company did not maintain a custodial agreement with this banking institution. On January 19, 2007, subsequent to the examination date, the Company executed a custodial agreement with Western National Trust Company to comply with U.A.C. Rule R590-178-5.

U.C.A § 31A-4-108 states that an insurer shall hold all investments and deposits of its funds in its own name except, securities kept under a custodial agreement. It is recommended that the Company execute a custodial agreement with UBS Financial. The custodial agreement should contain language that complies with U.A.C. Rule R590-178. In addition, pursuant to U.A.C. Rule R590-178-5(B), the agreement shall be in writing and shall be authorized by a resolution of the board. Assets held with the brokerage firm Grant Bettingen Inc. should be transferred to a qualified custodian pursuant to U.A.C. Rule R590-178-3(C) to be considered as admitted for statutory reporting purposes.

| | |
|---|---|
| **Common stocks** | **$1,200,000** |

Common stock in the amount of $1,200,000 was reported by the Company. Passco Realty Trust Company confirmed the Company owned the investment directly. It was valued by the NAIC Securities Valuation Office (SVO) on December 28, 2005.

| | |
|---|---|
| **Mortgage loans on real estate** | **$0** |

As of September 30, 2006, the Company reported mortgage loans in the amount of $3,749,300. The Company was not in compliance with U.C.A. § 31A-4-108 because the mortgage loans were not held in its own name. Pursuant to the NAIC Statements of Statutory Accounting Principles (SSAP) No. 4, adopted by U.C.A. § 31A-17-201, assets not owned and controlled by the reporting company shall be reported as a non-admitted asset and charged against surplus.

The examination did not allow the reported amount of $3,749,300, which consisted of 10 individual mortgage loans serviced by IEMC. The examination reviewed the supporting mortgage loan documents to ascertain ownership, valuation and admissibility. It was determined that the Company was not the owner or lender on the mortgage loans, rather IEMC was the lender on the copies of the Deed of Trusts that were provided. The examination noted that documentation on the 10 mortgage loans was incomplete in many cases. No copy of the Deed of Trust was provided for several of the mortgage loans. In some cases, a copy of a Corporate Assignment of Deed of Trust was provided, however it was incomplete and did not state to whom the mortgage loan was assigned and transferred. A copy of the Note was not provided in most instances, while many of the files contained an Allonge to Note that should have been attached to the Note. IEMC maintained the mortgage loans documentation in its office.

Subsequent to September 30, 2006, the examination noted that 7 of the 10 mortgage loans had been sold for $2,317,200. The 3 remaining mortgage loans were listed as assets by the Company in its records as of November 30, 2006, along with 18 additional mortgage loans totaling $5,691,000. Of these 18 additional mortgage loans, none contained the name of the Company on the Deed of Trust or title policy, rather the name was IEMC, and 6 did not identify the Company's name on the Allonge to Note.

**Cash, cash equivalents, and short-term investments** **$338,847**

As of September 30, 2006 the Company's cash consisted of various bank accounts. One cash account reported a short-term investment fund of $50,254.81. This amount was reported as cash in the 3rd Quarter Statement on page 2 line 5. It was not admitted by the examination, because there was no custodial agreement with Western National Trust Co. (See previous commentary under **Bonds, Preferred Stocks and Common Stocks**.) The examination recommends that this short-term investment fund be reclassified and reported on Schedule DA in the quarterly and annual statement filings and on page 2 line 1. A custodial agreement is required to consider the asset as admissible.

Two mutual funds in the amount of $108,984, were reported as cash equivalents. These investments should be reported as short-term investments on Schedule DA. The assets were directly held with Fidelity Investments as of September 30, 2006. The account was closed subsequently.

The examination admitted cash of $229,863, which is based on a calculation of 5% of assets of $2,597,257, or $129,863, plus $100,000 insured by the Federal Deposit Insurance Corporation (FDIC). U.C.A. § 31A-18-106(1)(a)(i) imposes a 5% limitation on investments in cash except as provided in Subsection (1)(a)(ii), for investments authorized under Subsection 31A-18-105(1) that are not amortizable under applicable valuation rules. Pursuant to U.C.A. § 31A-18-106(1)(a) (ii) the limitation of Subsection (1)(a)(i) and the limitation of Subsection (2) do not apply to demand deposits and certificates of deposit in solvent banks and savings and loan institutions to the extent they are insured by a federal deposit insurance agency. The FDIC limit is $100,000 per financial institution.

The Company did not comply with Article 5 Section 4 of its Bylaws, which states "All notes, drafts, checks, acceptances, endorsements, and subject to the provisions of these Bylaws, evidences of the indebtedness of the corporation shall be signed by such officer or said officers or such agent or agent of the corporation and in such manner as the Board of Directors may from time to time determine." The MidState Bank and UBS Financial Services accounts identified the Company President and the President's spouse as named account holders. The President's spouse, Jeannie Derr, is not an officer of the Company. In addition, signature cards on file with UBS Financial Services identified the President, Albert W. Kruger and Kenneth W. Kussoff as signatories on this account. Mr. Kruger and Mr. Kussoff were not listed as officers of the Company on the September 30, 2006 Jurat page. Mr. Kruger is the manager of the IEMC.

The Department recommends that only persons who are designated by the board be authorized as signatories in accordance with the Bylaws of the Company. Internal control procedures should be in place to notify the financial institutions when an officer is authorized as a signatory or when a person is no longer authorized to sign on the accounts. In addition, the Department recommends that the signatories of the two individuals named above be removed as authorized signers.

Other Invested Assets **$619,390**

Other Invested Assets consisted of various investments totaling $4,035,365 as of September 30, 2006.

| Description | | 9/30/2006 |
|---|---|---|
| Cornerstone Realty, LLC | $ | 475,150 |
| Empire Rail Company | | 681,000 |
| Paladin Realty | | 144,240 |
| Palm Beach Financial | | 800,000 |
| Sovereign Litigation Trust | | 1,200,000 |
| O'Moore Capital LLC | | 734,975 |
| **Other invested assets** | $ | 4,035,365 |

The examination determined two assets were admitted consisting of Cornerstone Realty, LLC of $475,150 and Paladin Realty of $144,240.

Other invested assets in the amount of $3,415,975 were considered non-admitted for examination purposes as described under the individual write-ups below.

*Cornerstone Realty, LLC*

Cornerstone Realty Fund, LLC in the amount of $475,150 was confirmed to be held directly in the name of the Company. The Company obtained a valuation from the NAIC

Securities Valuation Office (SVO) on December 28, 2005. This asset is considered admitted.

*Empire Railcar Corporation*

This asset in the amount of $681,000 consisted of seventeen railroad cars, which were purchased and owned directly by the Company as evidenced by observance of the certificates of title. The Company leases these railroad cars through a Railroad Equipment Management Agreement with California Railcar Corporation, effective May 4, 2005. The asset does not meet the definition of an equipment obligation or certificate under U.C.A. § 31A-18-105-(2), nor does it meet the asset admissibility test under SSAP No. 87, Paragraph 3. Therefore, the examination non-admitted the reported amount of $681,000.

*Paladin Realty Income Properties – Real Estate Investment Trust*

Other invested assets consisted of an investment with Paladin Realty Income Properties, Inc., a real estate investment trust (REIT) in the amount of $144,240. This asset was acquired on February 8, 2006, yet supporting documentation from the Company noted no filing with the SVO. REITs may have characteristics of debt or equity securities and may be reported on Schedule D when they are filed with the SVO. This asset was reported on Schedule BA, where it was treated as common stock by the examination. Common stock has a greater risk factor in the Risk Based Capital formula, so the examination chose this more conservative treatment, because there was no SVO valuation.

The Company should file this investment with the SVO to value the shares it still holds to be considered as an admissible asset going forward. Another alternative would be to dispose of the asset and replace it with permitted classes of investments according to U.C.A § 31A-18-105.

*Palm Beach Financial and Sovereign Litigation Trust (Now Known as Palm Beach Financial) - Litigation Notes*

Two investments which consisted of litigation notes in the amounts of $1,200,000 and $800,000 were determined as non-admitted, pursuant to U.C.A. § 31A-4-108. The investments are notes from criminal defense attorneys managed through an agreement with Daniels Capital Corporation. These litigation notes were non-admitted since documentation reviewed did not identify the name of the Company or ascertain ownership. Also, they do not meet the admissibility test under SSAP No. 87, Paragraph 3.

*Collateralized Loans - O'Moore Capital LLC*

Another invested asset consisted of 6 promissory notes, which were collateralized by property; reported in the amount of $734,975 as of September 30, 2006. The promissory notes were non-admitted by the Department. The Company loaned monies to O'Moore Capital, LLC, an affiliate, and the transactions were recorded in the form of promissory

notes. O'Moore Capital LLC, is 51% owned by the Company's President. Documentation was reviewed to verify the ownership, valuation and admissibility of this asset as of September 30, 2006. Subsequent transactions were also reviewed. The records were incomplete without proper appraisals.

A June 22, 2006 memo, attached to the June 23, 2006 board meeting minutes states that the board had approved the "O'Moore Mortgage Program." There was no evidence of board approval or discussion of the notes to O'Moore in the March 16, 2006 minutes. While the notes were discussed in the June 23, 2006 board meeting minutes, (one day after the memo stating they had been approved by the board), the same minutes note that "no resolution is made."

The memo states that O'Moore will pay the Company a 20% interest rate. The promissory notes were issued prior to July and August of 2006 lowering the interest rate to 12%, then revised on November 1, 2006 to lower the interest rate to 10%.

The Department recommends the board consider U.C.A § 31A-16-106 (1) (a) to determine that "transactions within a holding company system to which the Company is subject to registration is a party are subject to the following standards: (i) the terms shall be fair and reasonable; and (ii) charges or fees for services performed shall be reasonable."

The Company did not file a Form D "Prior Notice of a Transaction" with the commissioner, which is required under U.C.A § 31A-16-106(1)(b)(i)(B), because the aggregate sum of the collateralized loans exceeded the 3% of admitted assets threshold for life insurers. Furthermore, these material transactions were not disclosed in the Notes to Financial Statements as required by SSAP No. 25, paragraph 17.

The examination noted that four properties serving as collateral for the promissory notes amounting to $400,000 were not appraised. In discussion with the Company, valuation on these properties was provided using broker price opinions and comparative market analysis. It is the Department's understanding through review of the board minutes and corroborative inquiry that O'Moore Capital, LLC, purchases property that is in foreclosure at substantially less than its fair value by borrowing the money from the Company, paying interest to the Company, and eventually selling the property and paying off the promissory note. This appears to be a short-term arrangement.

SSAP No. 40 paragraph 12 states: "For all properties held for the production of income, the reporting entity must maintain an appraisal that is no more than five years old as of the reporting date. For all properties held for sale, an appraisal shall be obtained at the time such property is classified as held for sale, and subsequently an appraisal shall be maintained that is no more than five years old as of the reporting date. However, if conditions indicate there has been a significant decrease in the fair value of a property, a current appraisal shall be obtained. Additionally, appraisals shall be obtained for real estate investments at the time of foreclosure or contribution. Contributed real estate shall be supported by an independent third party appraisal at the date of contribution. If any of the

previous conditions exist but an appraisal has not been obtained, the related property shall be considered a non-admitted asset until the required appraisals are obtained."

As of November 30, 2006, subsequent to the examination date, the Company issued another promissory note to O'Moore Capital LLC in the amount of $79,000 on property located in Spokane, Washington. An appraisal was not obtained, and the Company did not submit a Form D to the commissioner for approval.

Pursuant to SSAP 40 paragraph 12, the Department recommends that the Company require appraisals on all of the properties used as collateral. It is recommended the Company file a Form D "Prior Notice of a Transaction" to obtain approval from the commissioner, to comply with U.C.A § 31A-16-106(1)(b)(i)(B), and work with the Department relating to the terms of the Form D. Also, these material transactions should be in the Notes to Financial Statements in future filings to comply with SSAP No. 25, paragraph 17.

**Investment income due and accrued** **$7,048**

The Company reported investment income due and accrued of $210,672. The examination determined that the interest on Paladin Realty and Cornerstone Realty LLC were allowable assets, therefore only the interest due and accrued for these assets were allowed in the amount of $7,048.

Actuary Opinion

**Aggregate Reserve for Life Contracts** **$19,991,362**

The Company obtained an Actuarial Opinion as of December 31, 2005 on the reported amount of $9,074,933 in Aggregate Reserve for Life Contracts. The ratio of the sum of the reserves and liabilities for annuities and deposits to the total admitted asset was more than .30, which meant the Company was not eligible for exemption found under U.A. C. Rule R590-162-6-(C)(1)(b), and it was required to obtain an asset adequacy test. Although reserves were considered adequate, the consulting actuary "was unable to form an opinion regarding the quality, liquidity, or durational characteristics of the assets, because the Company could not provide the requested information describing a significant portion of its assets." Therefore, the Actuarial Opinion did not include an asset adequacy analysis as required by U.A.C. Rule R590-162-8. It was submitted to the Department on May 30, 2006, although the NAIC Annual Statement Instructions requires it to be filed on or before March 1, 2006.

A limited actuarial analysis as of September 30, 2006 was prepared. Reserves increased 120 % to $19,991,362 from the $9,074,933 reported as of December 31, 2005. The primary purpose of this increase was to match the 89% growth in premiums for the nine months ended September 30, 2006.

The Department recommends the Company submit the annual Actuarial Opinion as of December 31, 2006, including an asset adequacy test, by the due date of March 1, 2007, to comply with U.C.A. § 31A-17-503 and U.A.C. Rule R590-162-8.

Capital and Surplus

The Company's capital and surplus was determined to be $18,490,535 less than reported in the Company's Quarterly Statement as of September 30, 2006. The following schedule identifies the examination changes:

| Description | Quarterly Statement | Per Examination | Surplus Increase (Decrease) |
|---|---|---|---|
| Bonds | $ 7,409,900 | $ 0 | $ (7,409,900) |
| Preferred stocks | 3,229,509 | 0 | (3,229,509) |
| Common stocks | 1,200,000 | 1,200,000 | 0 |
| First liens - mortgage loans on real estate | 3,749,300 | 0 | (3,749,300) |
| Cash and short-term investments | 821,074 | 338,847 | (482,227) |
| Other invested assets | 4,035,365 | 619,390 | (3,415,975) |
| Investment income due and accrued | 210,672 | 7,048 | (203,624) |
| Total changes | | 2,165,285 | (18,490,535) |
| Capital and surplus per Company | | | 563,808 |
| Capital and surplus per Examination | | | $ (17,926,727) |

As defined in U.C.A. § 31A-5-211(2)(a), the Company's minimum capital or minimum surplus requirement is $400,000. Pursuant to U.C.A. § 31A-5(3), prior to beginning operations, the Company was required to have total adjusted capital in excess of the company action level RBC as defined in Subsection 31A-17-601(8)(b). The Department required the Company have a total minimum capital and surplus of $600,000 to meet initial licensing requirements. The Company was out of compliance with the statutory deposit requirement in U.C.A. § 31A-5-211 on more than one occasion during the examination period. The Department notified the Company it is required to maintain its minimum deposit.

Based upon a preliminary analysis, the Company was notified it was in a company action level and a Risk Based Capital (RBC) action plan was requested by April 15, 2006. A copy of the RBC action plan is submitted on April 14, 2006. Further analysis showed that the Company's investments were inconsistent with the investment limitations specified in U.C.A. § 31A-18-106. The Company was notified that they were in a mandatory control level. Pursuant to U.C.A. § 31A-17-606(2)(d) the Department required the Company to correct the causes of the mandatory control level within ninety days.

The Company did not file 2005 audited financial statements as required by the NAIC Annual Statement Instructions, which were due May 1, 2006. According to U.A.C. Rule R590-147-5(3), the Department has the authority to recommend administrative penalties for failure to file supplemental documents with its annual statement filing.

The Company represented to the Financial Analysis Division of the Department the reason it was not audited by an external certified public accounting firm (CPA), is that the CPA would not perform an audit without an actuarial opinion. A report of its financial condition was requested as of July 31, 2006; due on August 11, 2006. Based upon verbal representations by the Company about where it had invested the excess cash and financial statements as of August 31, 2006, indications were that the Company was in a regulatory action level. The Department received the second RBC action plan on September 26, 2006, which was not considered acceptable and it was required to submit a new plan within forty-five days. On November 22, 2006, a detailed analysis based on the Company's September 30, 2006 Quarterly Statement determined that one of the other invested assets, a.k.a. "litigation notes," was not admissible. The Company was immediately notified it was in a mandatory control level and given until December 31, 2006 to come into compliance but subsequently was not able to do so. The Company was required to submit its balance sheet by January 12, 2007, showing its financial position as of December 31, 2006.

As of September 30, 2006, the Company reported $20,655,820 as total assets. The Financial Analysis Division of the Department determined to non-admit $2,144,240 of the litigation notes. This resulted in a decrease of total assets to $18,511,580. In accordance with U.C.A. 31A-17 Part 6, the Company's total adjusted capital was negative ($1,483,368), which placed the Company in a mandatory control level RBC requirement of $344,614, and a negative RBC ratio of -4.30% as of September 30, 2006.

The examination determined total adjusted capital as of September 30, 2006 to be negative ($17,829,663), after the examination adjustments. The examination determined the authorized control level RBC to be $397,848,and a mandatory control level of $278,494, resulting in a negative RBC ratio of -42.8%.

## CONCLUSION

Participants in this examination were Ms. Colette M. Reddoor, CFE, Assistant Chief Examiner and Mr. Jake Garn, CPA, Chief Examiner, who join the undersigned in acknowledging the assistance and cooperation extended during the course of the examination by officers, employees, and representatives of the Company.

Respectfully Submitted,

David A. Martinez

David A. Martinez, CFE, AIE
Examiner-In-Charge, representing the
Utah Insurance Department