MIKE KREIDLER
STATE INSURANCE COMMISSIONER

STATE OF WASHINGTON

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OFFICE OF
INSURANCE COMMISSIONER

In the Matter of	)	No. 08-96
	)	
The Financial Examination of	)	FINDINGS, CONCLUSIONS,
FARMERS NEW WORLD LIFE	)	AND ORDER ADOPTING REPORT
INSURANCE COMPANY	)	OF EXAMINATION

A Domestic Insurer.

BACKGROUND

An examination of the financial condition of **FARMERS NEW WORLD LIFE INSURANCE COMPANY** (the Company) as of December 31, 2006, was conducted by examiners of the Washington State Office of the Insurance Commissioner (OIC). The Company holds a Washington certificate of authority as a stock insurer. This examination was conducted in compliance with the laws and regulations of the state of Washington and in accordance with the procedures promulgated by the National Association of Insurance Commissioners and the OIC.

The examination report with the findings, instructions, and recommendations was transmitted to the Company for its comments on June 13, 2008. The Company's response to the report is attached to this order only for the purpose of a more convenient review of the response.

The Commissioner or a designee has considered the report, the relevant portions of the examiners' work papers, and the submissions by the Company.

Subject to the right of the Company to demand a hearing pursuant to Chapters 48.04 and 34.05 RCW, the Commissioner adopts the following findings, conclusions, and order.

FINDINGS

Findings in Examination Report. The Commissioner adopts as findings the findings of the examiners as contained in pages 1 through 21 of the report.

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CONCLUSIONS

It is appropriate and in accordance with law to adopt the attached examination report as the final report of the financial examination of **FARMERS NEW WORLD LIFE INSURANCE COMPANY** and to order the Company to take the actions described in the Instructions and Comments and Recommendations sections of the report. The Commissioner acknowledges that the Company may have implemented some of the Instructions and Comments and Recommendations prior to the date of this order. The Instructions and Comments and Recommendations in the report are appropriate responses to the matters found in the examination.

ORDER

The examination report as filed, attached hereto as Exhibit A, and incorporated by reference, is hereby ADOPTED as the final examination report.

The Company is ordered as follows, these being the Instructions and Comments and Recommendations contained in the examination report on pages 1-7.

1. The Company is ordered to comply with RCW 48.05.250 by filing its financial statements in the general form and context approved by the NAIC, and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P. Instruction 1, Examination Report, page 2.

2. The Company is ordered to comply with RCW 48.31B.030(1)(a) and SSAP No. 70 by maintaining documentation of the methods used to allocate expenses by parties involved in the intercompany billings and clearly and accurately disclosing the nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the charges or fees. Instruction 2, Examination Report, page 2.

3. The Company is also ordered to adhere to the terms of its intercompany contracts by documenting the review and approval of the allocation methods once per year and by settling balances according to the Agreement terms. Instruction 2, Examination Report, page 2.

4. The Company is ordered to comply with RCW 48.05.250 by filing a true annual statement and to follow NAIC Annual Statement Instructions and the AP&P, as required by WAC 284-07-050(2). The Company is also ordered to correct all deficiencies noted and execute revised or amended custodial agreements. Instruction 3, Examination Report, page 4.

5. The Company is ordered to comply with RCW 48.05.280 by keeping full and adequate accounts and records of its assets, obligations, transactions and affairs. Instruction 4, Examination Report, page 4.

6. The Company is ordered to comply with RCW 48.05.250 by filing its financial statements in the general form and context approved by the NAIC, and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P. Instruction 5, Examination Report, page 4.

7. The Company is ordered to ensure that the reserves are calculated in accordance with NAIC Actuarial Guidelines XXXIII and XXXIV, and to ensure that the CRVM initial expense allowance for traditional life business is calculated in accordance with NAIC Actuarial Guideline XVIII. This is in compliance with WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P which includes Actuarial Guidelines – Appendix C. Additionally, the Company must ensure that data input into its valuation system is correct. Instruction 6, Examination Report, page 5.

8. The Company is ordered to comply with RCW 48.05.250 by filing its financial statements in the general form and context approved by the NAIC, and with WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P which includes Actuarial Guidelines – Appendix C. Instruction 7, Examination Report, page 5.

9. The Company is ordered to allow for the substandard mortality, as appropriate, for the valuation of its reduced paid up policies originally issued to substandard lives. This recognition of the additional mortality is required with the opinion statement pursuant to WAC 284-07-380(2)(f)(v). Instruction 8, Examination Report, page 5.

10. Pursuant to WAC 284-84-050(2), the Company is ordered to perform tests to ensure that the policy reserves on Indeterminate Premium Universal Life is sufficient to cover a scale of cash surrender values. Instruction 9, Examination Report, page 6.

11. It is ordered that the Company consider incorporating testing for the non-forfeiture options in its cash flow testing projection model. It is also ordered that the Company consider sensitivity testing for these options to reflect outcomes in situations such as shock premium increases in low interest rate environments and anti-selection between healthy and unhealthy policy-owners in terms of reduced paid up or extended term options. Comments and Recommendations 1, Examination Report, page 6.

12. In view of the long term nature of its obligations under structured settlements, the Company, as suggested by NAIC Actuarial Guideline IX-B, is ordered to consider recognizing the yield on the supporting assets in conjunction with any other allocated assets such as those supporting the Interest Maintenance Reserve (IMR) in establishing the reserves for structured settlements. Comments and Recommendations 2, Examination Report, page 7.

IT IS FURTHER ORDERED THAT, the Company file with the Chief Examiner, within 90 days of the date of this order, a detailed report specifying how the Company has addressed each of the requirements of this order.

ENTERED at Olympia, Washington, this 30th day of June, 2008.

MIKE KREIDLER
Insurance Commissioner

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June 26, 2008

James T. Odiorne, CPA, JD
Deputy Insurance Commissioner
Washington State Office of the Insurance Commissioner
5000 Capitol Boulevard
Tumwater, WA 98501

Dear Mr. Odiorne:

The following are our responses to the instructions, comments and recommendations contained in the Report of the Financial Examination of Farmers New World Life Insurance Company, NAIC #63177, as of December 31, 2006. The instructions, comments and recommendations are numbered in accordance with the items in the original report. Also included are our responses for certain items in the body of the report where the Company proposes that additional edits, highlighted in red font, be made to the wording of the report. (See proposed edits on pages 10-12 of this letter.)

INSTRUCTIONS

1. Annual Statement Errors

The results of the examination disclosed several instances in which the Company's filing of the 2006 NAIC Annual Statement did not conform to the AP&P and the NAIC Annual Statement Instructions. While the Company needs to correct these deficiencies, none of the following items were material to the financial statements and no examination adjustments were necessary.

a. **Notes to Financial Statements, No. 10** - The Company did not disclose the amounts due from or due to related parties on the NAIC Annual Statements for the period under examination. This is required by the NAIC Annual Statement Instructions and SSAP No. 25, Paragraphs 17-18.

Company response:

The Company began including the detail of intercompany due to/from balances as a part of statement Note 10 D effective with its June 30, 2007 Quarterly Statement, which also includes prior year-end information.

b. **Liabilities, Surplus, and Other Funds** - The Company reported a liability of $25,386,790 on line 24.7: Funds held under coinsurance. This amount represents premiums received from policyholders as of December 31, 2006 but not yet paid to reinsurers. This does not meet the definition of funds held under coinsurance. Per the NAIC Annual Statement Instructions, the Company should have reported this amount on line 9.3 which is other amounts payable on reinsurance.

Company response:

The company will reclassify these amounts from page 3 line 24.7 to page 3 line 9.3 in its future statutory financial statement filings. The change in liability line classification will not impact the total amount of liabilities.

c. **Schedule of Assets, Liabilities, Surplus, and Other Funds** – The Company reported an asset in the amount of $5,199,795 for the Serviceman's Group Life Insurance (SGLI) receivable on page 2 line 13.1 unallocated premiums and agent's balances. This amount should have been reported on page 2, line 14.3, other amounts receivable under reinsurance contracts.

Company response:

The Company will reclassify its SGLI receivable from page 2 line 13.1 to page 2 line 14.3 in its future statutory financial statement filings. The change in asset line classification will not impact total amount of assets.

d. **Statement of Actuarial Opinion** - The Statement of Actuarial Opinion incorrectly stated that $0 was allocated to the Asset Valuation Reserve (AVR). It should have stated that $14,298,000 was allocated to the AVR. This error does not affect the financial statements.

The Company is instructed to comply with RCW 48.05.250 by filing its financial statements in the general form and context approved by the NAIC, and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P.

Company response:

2006 was the first year the Company included the AVR in cash flow testing (inclusion of the AVR in the cash flow tested amounts is optional), and the update to the Statement of Actuarial Opinion for this change was inadvertently overlooked. For 2007 the Statement of Actuarial Opinion is consistent with the cash flow testing memorandum.

2. Intercompany Allocations

The Memorandum of the Oral Administrative Services and Expense Sharing Agreement (Agreement) between FNWL and Farmers Group, Inc. (FGI) states: "Costs will be allocated utilizing time analysis methods, statistical means or other methodology deemed appropriate by the parties. Such allocation methods shall be reviewed and mutually agreed to by FGI and FNWL on an annual basis in the FNWL budgeting process." The Agreement also states that the amounts payable shall be determined and settled by FGI and FNWL monthly or as soon after the end of each month as can reasonably be performed. The Company settles the investment advisory charges once per year, which is not in accordance with the Agreement. The Company was unable to provide documentation to substantiate that expenses were allocated utilizing time analysis methods, statistical means or other methodology, or that the allocation methods were mutually agreed to by FGI and FNWL as required by the Agreement. We were therefore unable to verify that the charges allocated to FNWL were fair and reasonable, as required by RCW 48.31B.030

(1)(a), or that the method of allocation was in compliance with SSAP No. 70.

The Company is instructed to comply with RCW 48.31B.030(1)(a) and SSAP No. 70 by maintaining documentation of the methods used to allocate expenses by parties involved in the intercompany billings and clearly and accurately disclosing the nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the charges or fees. The Company is also instructed to adhere to the terms of its intercompany contracts by documenting the review and approval of the allocation methods once per year and by settling balances according to the Agreement terms.

Company response:

FNWL subsequently reviewed the allocated expense methodology of charges from FGI and has determined that the methodology supports the expense allocations as being fair and reasonable. However, FNWL is prepared to implement the following procedures to more clearly demonstrate that the method of allocation utilized is in compliance with SSAP No. 70 and that the charges allocated to FNWL under the methodology, and as mutually agreed to by FGI and FNWL, are fair and reasonable under RCW 48.31B.030(1)(a):

- *As part of the annual planning/budget cycle, FNWL will prepare a detailed listing of budgeted amounts, including calculation methods of allocated charges between FGI and FNWL;*

- *In place of the current e-mail approval of the total annual budgeted amount, the listing referenced above will be prepared in printed format, approved in writing by representatives from both FGI and FNWL, and retained in FNWL's permanent records.*

These revised procedures will be implemented effective with the 2009 planning/budget cycle, which is currently underway.

3. Custodial Agreement Deficiencies

Although the Company responded in its 2006 NAIC Annual Statement General Interrogatories, 24.01, that its custodial agreement with JPMorgan Chase Bank (JPMorgan) complied with the FCEH, it did not contain several provisions required by the FCEH. In addition, the Company's undisclosed custodial agreement with BNY did not contain all provisions required by the FCEH.

JPMorgan Chase Bank, N.A. Custodial Agreement, dated June 24, 2007

- The agreement does not state that securities shall be withdrawable upon demand of the Company.

BNY Securities Lending Agreement, dated May 24, 2005

- The agreement does not state that FNWL's customer account will be labeled in the name of FNWL, nor does it state that FNWL's securities held by BNY will be separately identified on BNY's records as being owned by FNWL.

- The agreement does not state that securities, other than those held to meet deposit requirements, are withdrawn upon demand by FNWL.
- The agreement does not require BNY to reimburse FNWL losses caused by BNY's ordinary negligence or employee misconduct.
- The agreement does not require that, in the event of a loss of securities for which BNY is obligated to indemnify FNWL, BNY shall promptly replace the securities or the value of said securities and the value of any loss of rights or privileges resulting from said loss of securities.
- The agreement states that BNY is not liable for acts beyond its "control" whereas the FCEH requires the term "reasonable control." The agreement also erroneously includes BNY's inability to obtain labor, material, equipment, services, or transportation as being beyond BNY's control. The FCEH does not define these scenarios as being beyond a custodian's reasonable control.
- In the event BNY gains entry into a clearing corporation through an agent, the agreement does not require BNY to enter into a written agreement subjecting the agent to the same liability as BNY for the loss of securities.
- The agreement does not require BNY to provide written notice to the OIC within three business days if the custodial agreement has been terminated or 100% of the account assets in any one custody account have been withdrawn.
- The agreement does not require that, on reasonable notice, FNWL, or an independent accountant selected by FNWL or the OIC, be allowed to examine BNY's records relating to FNWL's securities.
- The agreement does not require BNY and its agents, upon reasonable request, to send to FNWL all internal control reports received from a clearing corporation which the clearing corporation permits to be redistributed, or such reports prepared by BNY's outside auditors.
- The agreement does not require BNY to maintain records sufficient to verify certain information relied upon by FNWL in preparation of its annual statement and supporting schedules.
- The agreement does not require BNY to provide, upon written request from the OIC or FNWL, the appropriate affidavits, with respect to FNWL's securities held by BNY.
- The agreement does not require BNY to secure and maintain insurance protection in an adequate amount.
- The agreement does not require loaned securities be held by a qualified custodian under RCW 48.13.450(6).

The Company is instructed to comply with RCW 48.05.250 by filing a true annual statement. The Company is instructed to follow NAIC Annual Statement Instructions and the AP&P, as required by WAC 284-07-050(2). The Company is instructed to correct all of the deficiencies noted above and execute revised or amended custodial agreements.

Company response:

In 2007, the Company executed a rider to its JPMorgan custodial agreement to remedy the deficiencies identified by the OIC and provided a copy to the OIC, which reviewed and approved the amended rider. The Company is in the process of revising the BNY custodial agreement to include language to comply with the Financial Condition Examiners Handbook.

4. Incomplete Accounts and Records

Several sampled policy files were missing various information such as policy acceptance letters, specification pages, and copies of the policy contract. The policy files did not contain full and adequate accounts and records of the Company's transactions and affairs, as required by RCW 48.05.280.

The Company is instructed to comply with RCW 48.05.280 by keeping full and adequate accounts and records of its assets, obligations, transactions and affairs.

Company response:

The Company respectfully points out that acceptance letters are not required in all instances and may not be generated depending upon the circumstances. The specification pages are not routinely retained by the Company in its policy files. If a policy contract is returned, the Company does retain a copy of the specification pages and the face page of the policy contract. The Company does retain copies of policy applications in its policy files. However, copies of the policy contracts are not routinely retained as these can be recreated by the Company's system upon request by the customer. Also, the Company has also recently implemented a new document imaging system that will support the maintenance of policy files by electronically capturing all policy records in a policy file to further enhance the maintenance and storage of policy records.

5. Securities Lending

The Company incorrectly included collateral of $337,018,097 within Aggregate write-ins for other than invested assets and Aggregate write-ins for liabilities, respectively on the NAIC Annual Statement. In accordance with Paragraph 56 of SSAP No. 91 (Accounting for Transfers and Servicing Assets and Extinguishments Liabilities), the Company should not reflect the collateral in the Company's balance sheet as an asset, and should not establish a liability for the return of the collateral when the pledged collateral is not available for the general use (restricted). The collateral is not available for general use (restricted) according to the Company's security lending agreement with Bank of New York.

The Company is instructed to comply with RCW 48.05.250 by filing its financial statements in the general form and context approved by the NAIC, and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P.

Company response:

The Company respectfully disagrees with the OIC that the securities lending collateral is restricted and has submitted a letter to Tim Hays, the OIC's Investment Specialist, further explaining the Company's position on the securities lending arrangement. The Company's position on this issue is supported by the Bank of New York as well the Company's external auditors. Additionally, the examiners of the California Department of Insurance did not raise this as an issue nor come to the same conclusion in their recent examination of the property and casualty companies of Farmers Group that utilize the same securities lending arrangement. The Company *has requested and is awaiting additional clarification and specification from the OIC regarding their objections to the language of the securities lending agreement and the nature of their determination. The Company stands ready to discuss this issue further.*

6. NAIC Actuarial Guidelines

a. Variable Annuities
For variable annuities, FNWL's methodology ignores the potential of a free partial withdrawal immediately at the valuation date which is not in accordance with NAIC Actuarial Guidelines XXXIII and XXXIV. Additionally, there are errors in the durational premium data imported into the valuation system from the administration feed, which has resulted in the system's calculation algorithm being incorrectly applied to the different premium and surrender charge records.

b. Traditional Premium Paying Polices Reserve Calculations
The Company's terminal reserves for premium paying traditional life policies are somewhat lower, and at some early durations even negative, due to the manner in which its vendor purchased software calculates the initial expense allowance using continuous functions. While Actuarial Guideline XVIII permits the use of continuous functions in the calculation of the initial expense allowance, the resulting outcomes for terminal reserves should be consistent with those underlying the Commissioners Reserve Valuation Method (CRVM) as described in RCW 48.74.040 for curtate calculations. Additionally, the net deferred premiums (based on net rather than gross premiums) are also affected.

The Company is instructed to ensure that the reserves are calculated in accordance with NAIC Actuarial Guidelines XXXIII and XXXIV, and to ensure that the CRVM initial expense allowance for traditional life business is calculated in accordance with NAIC Actuarial Guideline XVIII. This is in compliance with WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P which includes Actuarial Guidelines – Appendix C. Additionally, the Company must ensure that data input into its valuation system is correct. Due to immateriality, no examination adjustments were necessary.

Company response:

Item 6a – Variable Annuities
The Company has modified its methodology to include free partial withdrawals on the valuation date (continuous free partial withdrawals) effective with the March 31, 2008 quarterly statement.

The Company has contacted its Third Party Administrator (TPA) for this block of business concerning the durational premium error in the extract file, and the TPA is working on a solution. The Company anticipates that the TPA will be able to correct the valuation extract file prior to December 31, 2008.

Item 6b Traditional Premium Paying Policies
The Company takes issue with the OIC's comments regarding the Company's reserving and expense allowance calculation methodology. The Company believes that its method of calculating the initial expense allowance is not inconsistent with those underlying the Commissioners' Reserve Valuation Method (CRVM) as described in RCW 48.74.040 for curtate calculations.

The Standard Valuation Law (SVL) defines the CRVM only on a curtate basis. Therefore, the law must be interpreted in applying it to calculations made on a continuous basis. Before Actuarial Guideline XVIII was promulgated, the most common interpretation of the SVL was to base the expense allowance -- "the excess of (1) over (2)" defined in the law -- on curtate rather than continuous functions, even when the reserves themselves were calculated on a continuous basis. The Actuarial Guideline now permits, but does not require, the use of continuous functions for the expense allowance when continuous functions are used for the reserves.

FNWL's traditional life reserves are calculated using discounted continuous functions. The PC based valuation system (ARCVAL) used by FNWL employs the method permitted by Actuarial Guideline XVIII, and bases the expense allowance on continuous rather than curtate functions.

Questions of interpretation, however, not answered by either the SVL or the Actuarial Guideline, still remain. The expense allowance is defined in the SVL to be "the excess of (1) over (2)," where (1) is the lesser of (a) a net level premium for an otherwise similar policy issued one age higher than the actual age and (b) the net level 19-pay whole life premium issued one age higher, and (2) is a one-year term premium for the first-year benefits. A question of interpretation here is whether the premiums defined should be continuous premiums or discounted continuous premiums. The vendor of our valuation software has interpreted them to be continuous premiums, and we believe this to be a valid interpretation of the law, even though we recognize that it would also be valid to interpret them as discounted continuous premiums. It should be noted that using continuous premiums results in small negative first-year terminal reserves in some circumstances, while using discounted continuous premiums would eliminate these negatives. The SVL, however, is silent about whether terminal reserves can be less than zero, just as it is silent about whether the first-year net premium must equal or exceed the first-year benefits.

Because the Company recognizes that an alternative interpretation of the SVL might be more readily accepted, we have, over the past two years, been having ongoing discussions with our vendor regarding the possibility of adding an option to allow the premiums in the expense allowance calculation to be discounted continuous rather than pure continuous. We intend to continue these discussions with our vendor, and to implement the alternative interpretation described above for our traditional life policies.

7. Advance Premiums

The Company incorrectly classifies modal premiums received for amounts attributable to modal premium due dates after the valuation date but prior to the next policy anniversary as advance premiums. This does not adhere to SSAP 51 No. 25 which defines advance premiums as those premiums received by the reporting entity prior to the valuation date but which are due on or after the next policy anniversary date.

The Company is instructed to comply with RCW 48.05.250 by filing its financial statements in the general form and context approved by the NAIC, and with WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P which includes Actuarial Guidelines – Appendix C.

Company response:

While the Company recognizes that its method of accounting for modal premiums for the current policy year paid prior to their due dates does not conform to SSAP 51, our understanding was that the method we are using, and have been using for the past twenty plus years, was an acceptable alternative. The Company's method is more conservative. The difference in the two methods is primarily one of presentation and has minimal financial impact.

We will evaluate the resource and expense requirements of implementing this change in methodology for policies issued on or after January 1, 2001 (the effective date of codification), as well as the financial impact, and we will either implement the change or demonstrate the immateriality of the difference between the Company's current methodology and that proscribed by SSAP No. 51.

8. Substandard Reduced Paid-Up Policies

The Company does not use substandard mortality tables for reserves on substandard paid up polices. This is inconsistent with the paragraph required by WAC 284-07-380(2)(f)(v) in the Company's actuarial opinion.

The Company is instructed to allow for the substandard mortality, as appropriate, for the valuation of its reduced paid up policies originally issued to substandard lives. This recognition of the additional mortality is required with the opinion statement pursuant to WAC 284-07-380(2)(f)(v). Due to immateriality, no examination adjustment was necessary.

Company response:

The Company does not believe that the small understatement in reserves resulting from not reflecting substandard mortality on approximately 5% of its reduced paid up policies (0.02% of the Company's in force and 0.44% of reserves as of December 31, 2006) is inconsistent with the statement in the Company's actuarial opinion referenced by the OIC ("In my opinion the reserves and related actuarial values... include provision for all actuarial reserves and related statement items which ought to be established.").

The Company's administrative system is not capable of carrying substandard information on reduced paid-up policy records and therefore the data is not passed to the valuation system for the purposes of calculating additional substandard reserves on a seriatim basis. The Company will, however, develop a method to estimate the additional reserve amount for substandard reduced paid up policies and include this estimated amount in the Company's financial statements effective December 31, 2008.

9. Indeterminate Premium Universal Life

The Company does not test the reserves on Indeterminate Premium Universal Life to see if the basic policy reserves calculation pursuant to WAC 284-84-030 is sufficient to cover a scale of cash surrender values in accordance with WAC 284-050(2).

Pursuant to WAC 284-84-050(2), the Company is instructed to perform tests to ensure that the policy reserves on Indeterminate Premium Universal Life is sufficient to cover a scale of cash surrender values. Due to immateriality, no examination adjustment was necessary.

Company response:

A literal reading of WAC 284-84 would suggest that this product should be treated as fixed premium universal life for reserve calculations. This product does not specify the premium to be paid beyond the fifth policy year, thus a premium assumption is necessary to apply the fixed premium reserve methodology. However, the fixed premiums reserve methodology does not have a mechanism to correct for differences between the premiums assumed in calculating the reserves and the actual premiums received. This is a significant deficiency in applying the fixed premium methodology.

After a thorough review of the NAIC Universal Life Model Regulation and Washington's fixed premium universal life regulation in 1991, the Company concluded that it would be more appropriate, and conservative as well, to value its Indeterminate Premium Universal Life policies using the NAIC Universal Life Model Regulation, and we have done so since year end 1991. Neither the Standard Valuation Law nor the NAIC Universal Life Model Regulation specifically requires the prefunding of cash values.

The Company's first Indeterminate Premium Universal Life product was introduced in 1984, several years prior to the adoption of Washington's fixed premium universal life regulation (WAC 284-84). Furthermore, the majority of our Indeterminate Premium Universal Life policies in force as of December 31, 2006 were issued prior to the January 1, 1987 effective date of WAC 284-84.

As of December 31, 2006 reserves on the entire block of Indeterminate Premium Universal Life business were 102.4% of net cash values (account value less surrender charge, but not less than the minimum cash value).

As outlined above we believe our current reserve methodology for this product is appropriate. We will however, test that our reserves for policies issued 1-1-87 and after are sufficient to cover the scale of cash surrender values included in the Company's Indeterminate Premium Universal Life policies.

COMMENTS AND RECOMMENDATIONS

1. Indeterminate Premium Universal Life Policies – Non-Forfeiture Benefits

The Company's Indeterminate Premium Universal Life Policies provide for non-forfeiture benefits (Reduced Paid-Up and Extended Term Insurance) originating from minimum surrender values to be calculated at a guaranteed rate of 7%. Under RCW 48.74.030 (3)(b) these benefits would be valued at lower rates of interest following conversion to the non-forfeiture benefits which would result in a negative financial impact on the statutory books. To the extent that the conversion activity is minor as is currently the case, the impact is inconsequential. However, should the level of this activity increase significantly, there could be a significant, adverse financial impact to the Company.

It is recommended that the Company consider incorporating testing for the non-forfeiture options in its cash flow testing projection model. It should also consider sensitivity testing for these options to reflect outcomes in situations such as shock premium increases in low interest rate environments and anti-selection between healthy and unhealthy policy-owners in terms of reduced paid up or extended term options.

Company response:

The Company proposes that the first paragraph of Comment and Recommendation #1 be edited to read as follows:

> ***"1. Indeterminate Premium Universal Life Policies – Non-Forfeiture Benefits***
>
> *The Company's Indeterminate Premium Universal Life Policies provide for non-forfeiture benefits (Reduced Paid-Up and Extended Term Insurance) originating from minimum surrender values to be calculated at a guaranteed rate of 7%. Under RCW 48.74.030 (3)(b) these benefits would be valued at lower rates of interest following conversion to the non-forfeiture benefits which would result in a negative financial impact on the statutory books in the year of conversion. To the extent that the conversion activity is minor as is currently the case, the impact is inconsequential. However, should the level of this activity increase significantly, there could be a temporary ~~significant~~, adverse financial impact to the Company (which would be reversed in subsequent years as the policies that convert to Reduced Paid-Up and Extended Term Insurance run off the books)."*

The Company has experienced an extremely low level of RPU elections historically. During 2006 and 2007 there were 118 and 86, respectively, which equate to .2% and .1% of the in force at the beginning of each period. There were 141 ETI elections in 2006. Although the Company does not currently include RPU/ETI elections in our cash flow testing, as we don't believe the impact would be material, the Company will consider incorporating testing of these elections into our cash flow testing model.

2. Structured Settlements

In calculating the structured settlement reserves, the valuation uses interest rates that are in some cases higher than rates available on investments backing the structured settlement liabilities. In view of the long term nature of its obligations under structured settlements, the Company, as recommended by NAIC Actuarial Guideline IX-B should recognize the yield on the supporting assets in conjunction with any other allocated assets in establishing the liability for structured settlements.

In view of the long term nature of its obligations under structured settlements, the Company, as suggested by NAIC Actuarial Guideline IX-B, should recognize the yield on the supporting assets in conjunction with any other allocated assets such as those supporting the Interest Maintenance Reserve (IMR) in establishing the reserves for structured settlements.

Company response:

The Company proposes that the first paragraph of the Comment and Recommendation #2 be edited to strike the second sentence as it is repeated in the instruction that follows but it does not include the reference to the IMR that the instruction does and should read as follows:

> ***"2. Structured Settlements***
>
> *In calculating the structured settlement reserves, the valuation uses interest rates that are in some cases higher than rates available on investments backing the structured settlement liabilities. ~~In view of the long term nature of its obligations under structured settlements, the Company, as recommended by NAIC Actuarial Guideline IX-B should recognize the yield on the supporting assets in conjunction with any other allocated assets in establishing the liability for structured settlements.~~"*

The Company believes that it is already in compliance with this recommendation in that (1) our annual cash flow testing projections reflect the current yields on the assets supporting the Structured Settlements line of business, and (2) these assets include a portion of the assets allocated to the company's IMR.

While FNWL has sold some higher yielding assets assigned to Structured Settlements and replaced them with lower yielding assets, the capital gains realized were placed in the IMR, and are being amortized over the life of the original assets. Setting aside realized capital gains in the IMR, and additionally increasing reserves by lowering valuation interest rates would be an unnecessary duplication. As of December 31, 2006 the Company's IMR was $36.3 million, and the Company believes this reserve is sufficient to account for the reduced yields in the asset portfolio supporting to the Structured Settlements line of business.

Our cash flow testing as of December 31, 2006 demonstrated that the assets assigned to the Structured Settlements line of business are adequate to support the future liabilities, and it is the opinion of our Appointed Actuary that no additional reserves are necessary.

Additionally, the Company noted the following in the body of the report in the fourth paragraph under the heading of Mortality and Loss:

In the OIC Actuary's opinion reserves were within a reasonable range and except for Instructions No. 6-9 and Comments and Recommendations No.1 and 2, the methods, assumptions and methodologies used by the Company were appropriate, and all material relevant assets and liabilities on the NAIC Annual Statement were reported in accordance with accepted methods and principles.

Company response:

The Company proposes that this paragraph be edited to read as follows:

"In the OIC Actuary's opinion reserves were within a reasonable range, and ~~except for~~ subject to his findings as noted in Instructions No. 6-9 and Comments and Recommendations No. 1 and 2, the methods, assumptions and methodologies used by the Company were appropriate, and all material relevant assets and liabilities on the NAIC Annual Statement were reported in accordance with accepted methods and principles."

We look forward to receiving your responses and if there is anything further you would like to discuss in the interim, please feel free to let us know.

Sincerely,

Oscar C. Tengtio
Chief Financial Officer

Cc: Brian Kreger
Ryan Larson
Joni Cervenka
Leeann Badgett
John Moret