

**ARIZONA LIFE AND DISABILITY
INSURANCE GUARANTY FUND**

2018 ANNUAL REPORT

REPORT FROM THE CHAIR OF THE BOARD OF DIRECTORS

On behalf of the Arizona Life and Disability Insurance Guaranty Fund ("ALDIGF"), I am pleased to present the 2018 Annual Report. This report is prepared and submitted pursuant to A.R.S. § 20-691.

The ALDIGF Board of Directors met two times in 2018, on May 15, and again on November 13, the Annual Meeting, at which officers were elected and standing committees were appointed.

ALDIGF was activated for no new insurer insolvencies in 2018. The most significant activity for ALDIGF was paying long term care insurance claims of Penn Treaty Network America Insurance Company ("Penn Treaty") and its subsidiary, American Network Insurance Company ("ANIC"). ALDIGF also paid claims in 2018 with respect to Executive Life Insurance Company (life insurance), Life and Health Insurance Company of America (long term care), Lincoln Memorial Life Insurance Company (life insurance), Meritus Mutual Health Partners (health insurance), National States Insurance Company (long term care), and Standard Life Insurance Company of Indiana (annuities).

Member insurers are subject to two types of assessments from ALDIGF: Class A and Class B. Class A assessments provide for administrative and operating expenses of ALDIGF. Class B assessments provide for the payment of policyholder claims. A Class B assessment in the amount of \$9.2 million on the Disability Account for Penn Treaty and ANIC was approved on November 13, 2018 at the 2018 Annual Meeting.

ALDIGF is a member of and works closely with and through the National Organization of Life and Health Insurance Guaranty Associations ("NOLHGA") with respect to multi-state insurer insolvencies. Representatives of ALDIGF are active on NOLHGA insolvency task forces and committees. Membership and participation in NOLHGA helps ALDIGF achieve efficiencies in performing its statutory duties that would not be possible if ALDIGF acted on its own.

ALDIGF uses all of the tools at its disposal to protect Arizona resident policyholders in the unfortunate event of insurer insolvency, acting with transparency and due diligence in regard to its finances and operational matters.

Respectfully,

Tod D. Lashway, CLU, ChFC, LUTCF, CLTC

Chair of the Board of Directors

DESCRIPTION OF THE FUND AND ITS BOARD OF DIRECTORS

The Arizona Life and Disability Insurance Guaranty Fund (“ALDIGF”) was created in 1977 by the Arizona legislature. ALDIGF is within the Arizona Department of Insurance and is governed by A.R.S. §§ 20-681 through 20-695.

The purpose of ALDIGF is to protect Arizona resident policyholders and their beneficiaries in the event of the insolvency of an insurance company that is licensed to write life, annuity, disability or accident and health business in Arizona.

ALDIGF is responsible for continuing insurance coverage for Arizona policyholders, including paying claims and other policy benefits, subject to the terms of the policy and statutory limitations on benefits.

When a court finds that an insurance company is insolvent and orders that it be liquidated, a receiver takes control of the insurer under the court’s supervision and liquidates the insurer’s assets. ALDIGF becomes a creditor of the insolvent insurer to the extent of the payments and benefits it provides to policyholders and the expenses it incurs in performing its statutory obligations. If estate assets allow, the receiver may advance money to the affected guaranty funds/associations to assist in the payment of claims. ALDIGF typically recovers a portion of the costs of providing policyholder benefits from the estate of the insolvent insurer. If additional funds are needed to pay policyholder claims and benefits, ALDIGF’s Board of Directors may levy an assessment on member insurance companies.

An insurance company becomes a member insurer of ALDIGF by operation of law upon becoming licensed to write a line of business for which coverage is provided by ALDIGF. Some insurance companies are excluded from membership in ALDIGF, such as fraternal benefit societies, service corporations, prepaid dental plans and health care service organizations.¹

ALDIGF is governed by a nine member Board of Directors appointed by the Governor upon recommendations made by the Director of Insurance.² Day to day operations are managed by an Executive Director and support staff.

The Board of Directors typically meets twice each year, in May and again in November. The November meeting is the annual meeting at which officers are elected

¹ The ALDIGF enabling act was amended to include health care service organizations as member insurers effective January 1, 2019.

² The enabling act was also amended effective January 1, 2019 to add two board members representing health insurers.

BOARD OF DIRECTORS

Chair

Tod D. Lashway, ChFC, CLU, LUTCF, CLTC
American United Life Insurance Company
Scottsdale, AZ
Current term expires August 27, 2019

Vice Chair

Mark A. Haydukovich, ChFC, CLU, CPA, FLMI, CFA
President and Chief Executive Officer
Oxford Life Insurance Company
Phoenix, AZ
Current term expires August 27, 2020

Secretary/Treasurer

John R. Mathews, Esq., CPA
Consultant (Retired from Allstate Insurance Companies)
Lake Bluff, IL
Current term expires August 27, 2020

Robert C. Corn, Esq.
Manager, Regulatory Relations
Mutual of Omaha
Omaha, NE
Current term expires August 27, 2021

Elizabeth A. Heisler
Actuary
Northwestern Mutual Life Insurance Company
Milwaukee, WI
Current term expires 08/27/2021

Michael Hickey, Esq.
Vice President, Government & Industry Relations
Metropolitan Life Insurance Company
Kensington, MD
Current term expires August 27, 2021

GOVERNANCE

ALDIGF's activities and operations are governed by its enabling act, A.R.S. §§ 20-681 – 20-695, a Plan of Operation, developed by the Board and approved by the Director of Insurance, and an Investment Policy, also developed by the Board and approved by the Director of Insurance. The Board has also adopted an Anti-Trust Compliance Policy. The policies may be amended from time to time as the Board deems it necessary and appropriate.

**ARIZONA LIFE AND DISABILITY
INSURANCE GUARANTY FUND**

**STATEMENT OF CASH RECEIPTS, DISBURSEMENTS,
AND CHANGES IN CASH AND INVESTMENT
BALANCES AND INDEPENDENT AUDITORS' REPORT**

YEAR ENDED DECEMBER 31, 2018

John C. Todd II, P.C.
Certified Public Accountants

Member
American Institute of CPAs
Arizona Society of CPAs
Government Audit Quality Center

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Independent Auditors' Report

The Board of Directors
Arizona Life and Disability Insurance Guaranty Fund

Financial Statements

We have audited the accompanying statement of cash receipts, disbursements, and changes in cash and investment balances of Arizona Life and Disability Insurance Guaranty Fund (Fund), a division of the Arizona Department of Insurance, as of and for the year ended December 31, 2018, and the related notes to the financial statement, which collectively comprise the Fund's basic financial statement as listed in the table of contents.

Management's Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of this financial statement in accordance with the modified cash basis of accounting as described in Note 1; this includes determining that the modified cash basis of accounting is an acceptable basis for the preparation of the financial statement in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statement that is free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on this financial statement based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statement.

**ARIZONA LIFE AND DISABILITY INSURANCE GUARANTY FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
YEAR ENDED DECEMBER 31, 2018**

This section of the Arizona Life and Disability Insurance Guaranty Fund's (the "Fund") annual report presents management's discussion and analysis of the Fund's financial performance during the year ended December 31, 2018. This section of the report should be read in conjunction with the Fund's financial statements.

FINANCIAL HIGHLIGHTS

- As of the close of the current fiscal and calendar year, the Fund reported an ending Fund Balance of \$19,547,019.
- The Fund was activated for no new insolvency cases in 2018.
- One assessment on member companies was levied in 2018. An assessment of \$ 9.2 million was levied on the Disability Account for Penn Treaty and ANIC. The assessment was approved by the Board of Directors on November 13, 2018. No refunds were issued to member insurers in 2018.
- Total receipts for the year were \$8,273,509:
 - Total receipts from receivership and early access distributions for the year were \$984,215.
 - Income on the Fund's investments for the year was \$396,226 (net of amortization/accretion and unrealized gain/loss).
 - Premium receipts for the year were \$27,119.
 - Assessment receipts for the year were \$6,865,949
- Total disbursements for the year were \$13,198,421:
 - The Fund paid \$12,242,873 in claims in 2018:
 - \$68,470 in life insurance claims.
 - \$12,139,616 in disability insurance claims, most of which was for claims under long term care policies of Penn Treaty and ANIC.
 - \$34,787 in annuity claims.
 - The Fund paid administrative expenses of \$955,548 in 2018.
 - Includes \$538,111 in NOLHGA dues and quarterly assessments for insolvency activity.

**ARIZONA LIFE AND DISABILITY INSURANCE GUARANTY FUND
MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)
YEAR ENDED DECEMBER 31, 2018**

CURRENT KNOWN FACTS, DECISIONS OR CONDITIONS

The Fund was activated for no new impaired/insolvent insurers in 2018. However, the estimated liabilities to Arizona policyholders for two Pennsylvania domiciled long term care insurers placed in liquidation as of March 1, 2017 are \$198,834,000 on an undiscounted basis. The Fund has opted to pay its policyholder liabilities on an annual basis. Accordingly, the Fund expects to levy assessments annually on the Disability Account until the liabilities are retired.

The Fund has sufficient assets in its Life Account and Annuity Accounts to pay the remaining liabilities of insurer insolvencies that have occurred to date which affect those accounts.

CONTACTING THE FUND'S FINANCIAL MANAGEMENT

This financial report is designed to provide a general overview of the Fund's finances. If you have questions about this report or need additional financial information, please contact the Fund's Executive Director at 100 North 15th Avenue, Suite 102, Phoenix, Arizona 85007, (602) 364-3863 or msurguine@azinsurance.gov.

**ARIZONA LIFE AND DISABILITY INSURANCE GUARANTY FUND
STATEMENT OF CASH RECEIPTS, DISBURSEMENTS, AND
CHANGES IN CASH AND INVESTMENT BALANCES
YEAR ENDED DECEMBER 31, 2018**

Cash Receipts:	
Receivership distributions	\$ 984,215
Assessments	6,865,949
Premium payments	27,119
Interest income	<u>415,578</u>
Total cash receipts	8,292,861
Cash Disbursements:	
Disability insurance claims	12,139,616
Life insurance claims	68,470
Annuity claims	34,787
Administrative expenses	<u>955,548</u>
Total cash disbursements	13,198,421
Cash disbursements in excess of cash receipts	(4,905,560)
Amortization/accretion of investments	(45,156)
Net realized/unrealized gain (loss) on investments	<u>25,804</u>
Total change in investments	<u>(19,352)</u>
Total changes in cash and investments	(4,924,912)
Cash and investment balance at January 1, 2018	<u>24,471,931</u>
Cash and investment balance at December 31, 2018	<u><u>\$ 19,547,019</u></u>

See accompanying notes to basic financial statements.

ARIZONA LIFE AND DISABILITY INSURANCE GUARANTY FUND
NOTES TO BASIC FINANCIAL STATEMENT
DECEMBER 31, 2018

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity - The Arizona Life and Disability Insurance Guaranty Fund (Fund), a division of the Arizona Department of Insurance, was established by the Arizona legislature in 1977 to provide funds for the payment of contractual obligations under certain life, disability and annuity insurance contracts of insolvent insurance companies in accordance with *Arizona Revised Statutes, Title 20, Chapter 3, Article 7*.

The Fund is managed by a nine-member board of directors appointed by the Governor of the State of Arizona and is under the immediate supervision of an Executive Director. In order to provide the monies necessary to carry out the powers and duties of the Fund, the board of directors determines the amount and timing of assessments to be made upon member insurers. Member insurers are those individuals or companies authorized to transact the covered types of insurance in the State of Arizona.

Basis of Accounting – Basis of accounting refers to when revenues and expenditures/expenses are recognized in the accounts and reported in the financial statement. The financial statement is presented on the modified cash basis of accounting, which is special purpose framework of accounting. Under the modified cash basis, revenues are recognized when received rather than when earned and expenses are recognized when paid rather than when the obligation is incurred. Changes in the fair value of investments and reductions in premiums/discounts relating to investments held by the Fund are also included. In addition, all items including the acquisition of furniture and equipment are expensed as paid and receivables, prepaids, payables and accrued expenses are not reported. Accordingly, the financial statement is not intended to present financial position and results of operations in conformity with U.S. generally accepted accounting principles.

Cash and Investments – Cash includes amounts in demand deposits as well as short-term investments with an original maturity date within three months of the date acquired by the Fund. Investments are carried at fair value. Changes in fair value and amortization of premiums/discounts relating to investments held by the Fund are reported as changes in investment balances.

Income Taxes – The Fund operates as a tax-exempt organization for federal and state income tax purposes under Section 115 (1) of the Internal Revenue Code; however, a determination letter has not been requested from the Internal Revenue Service.

Subsequent Events – The Fund has reviewed all subsequent events through May 9, 2019, which was the date the financial statements were available to be issued.

**ARIZONA LIFE AND DISABILITY INSURANCE GUARANTY FUND
NOTES TO BASIC FINANCIAL STATEMENT
DECEMBER 31, 2018**

NOTE 2 – CASH AND INVESTMENTS (CONT'D)

Concentration of Credit Risk-Investments – The Fund's investment policy requires investments to be no more than 5 percent invested with any one issuer, with the exception of the United States Government and its agencies or instrumentalities. The Fund has no formal policies regarding credit risk.

Custodial Credit Risk – Investments – For an investment, custodial credit risk is the risk that, in the event of the counterparty's failure, the Fund will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Fund has no formal policy regarding custodial credit risk.

Interest Rate Risk – The Fund's investment policy requires an average duration to not exceed 1 year. The maximum final maturity on an individual investment shall not exceed 3 years. At December 31, 2018, the Fund had the following investments in debt securities:

Investment Type	Amount	Weighted Average Maturity in Months
Corporate bonds	\$ 10,564,151	23.6
U. S. Treasury bill	7,840,468	21.1
Municipal bonds	249,169	21.6
	\$ 18,653,788	

NOTE 3 – ACCOUNT BALANCES

The Fund maintains four restricted accounts for purposes of reporting cash receipts and disbursements and investment income. In accordance with Arizona State statutes, the Fund may transfer amounts between accounts. The balances for each account as of December 31, 2018 are as follows:

Annuity account	\$ 10,585,971
Disability account	3,756,576
Life account	3,087,846
Administrative account	2,116,626
	\$ 19,547,019

**ARIZONA LIFE AND DISABILITY INSURANCE GUARANTY FUND
NOTES TO BASIC FINANCIAL STATEMENT
DECEMBER 31, 2018**

NOTE 5 – RETIREMENT PLAN (CONT'D)

Benefits Provided – The ASRS provides retirement, health insurance premium supplement, long-term disability, and survivor benefits. State statute establishes benefit terms. Retirement benefits are calculated on the basis of age, average monthly compensation, and service credit as follows:

ASRS	Initial membership date:	
	Before July 1, 2011	On or after July 1, 2011
Years of service and age required to receive benefit	Sum of years and age equals 80 10 years, age 62 5 years, age 50* any years, age 65	30 years, age 55 25 years, age 60 10 years, age 62 5 years, age 50* any years, age 65
Final average salary is based on	Highest 36 consecutive months of last 120 months	Highest 60 consecutive months of last 120 months
Benefit percent per year of service	2.1% to 2.3%	2.1% to 2.3%

*With actuarially reduced benefits

Retirement benefits for members who joined the ASRS prior to September 13, 2013, are subject to automatic cost-of-living adjustments based on excess investment earning. Members with a membership date on or after September 13, 2013, are not eligible for cost-of-living adjustments. Survivor benefits are payable upon a member's death. For retired members, the retirement benefit option chosen determines the survivor benefit. For all other members, the beneficiary is entitled to the member's account balance that includes the member's contributions and employer's contributions, plus interest earned.

Contributions - In accordance with state statutes, annual actuarial valuations determine active member and employer contribution requirements. The combined active member and employer contribution rates are expected to finance the costs of benefits employees earn during the year, with an additional amount to finance any unfunded accrued liability. For the year ended June 30, 2018, active ASRS members were required by statute to contribute at the actuarially determined rate of 11.50 percent (11.34 percent for retirement and 0.16 percent for long-term disability) of the members' annual covered payroll, and the Fund was required by statute to contribute at the actuarially determined rate of 11.50 percent (10.9 percent for retirement, 0.44 percent for health insurance premium benefit, and 0.16 percent for long-term disability) of the active members' annual covered payroll.

**ARIZONA LIFE AND DISABILITY INSURANCE GUARANTY FUND
SCHEDULE OF ADMINISTRATIVE EXPENSES
YEAR ENDED DECEMBER 31, 2018**

NOLHGA dues and assessments	\$ 538,111
Staff salaries and employee related expenses	192,282
Claims and adjusting services	147,500
Investment fees	17,077
Rent	7,130
Other operating expenses	27,597
Travel	3,978
Financial audit service	5,520
Legal services	6,500
Banking service fees	7,200
Detection and prevention of insolvencies	<u>2,653</u>
	<u>\$ 955,548</u>