

Examination Warrant Number 08-LH-383-Z

Report of Examination of

Colonial American Life Insurance Company
Souderton, Pennsylvania

As of December 31, 2008

For Informational Purposes Only

Colonial American Life Insurance Company

TABLE OF CONTENTS

Subject	Page
Salutation.....	1
Scope of Examination.....	1
History	2
Management and Control:	
Capitalization.....	2
Stockholder.....	3
Insurance Holding Company System.....	3
Board of Directors	5
Officers	6
Corporate Records:	
Minutes	7
Articles of Incorporation.....	8
By-laws	8
Service and Operating Agreements	8
Reinsurance:	
Ceded.....	9
Assumed	9
Territory and Plan of Operations	10
Significant Operating Trends.....	10
Accounts and Records	11
Pending Litigation	11
Financial Statements:	
Comparative Statement of Assets, Liabilities, Surplus and Other Funds.....	13
Comparative Statement of Income	14
Comparative Statement of Capital and Surplus.....	15
Comparative Statement of Cash Flow.....	16
Summary of Examination Changes	17
Notes to Financial Statements:	
Investments.....	17
Policyholder and Claim Reserves.....	18
Subsequent Events.....	19
Recommendations:	
Prior Examination.....	19
Current Examination.....	20
Conclusion.....	21

Harrisburg, Pennsylvania
April 7, 2010

Honorable Stephen J. Johnson, CPA
Deputy Insurance Commissioner
Commission
Commonwealth of Pennsylvania
Insurance Department
Harrisburg, Pennsylvania

Honorable Alfred W. Gross
Commissioner of Insurance, and
Chair, E Committee, NAIC
Virginia State Corporation Commission
Bureau of Insurance
P. O. Box 1157
Richmond, VA 23218

Honorable Paulette Thabault
Insurance Commissioner
and Secretary, Northeastern Zone, NAIC
Department of Banking, Insurance, Securities and
Health Care Administration
89 Main Street
Montpelier, Vermont 05620-3101

Dear Commissioners and Deputy Commissioner:

In accordance with instructions contained in Examination Warrant Number 08-LH-383-Z, dated, February 29, 2008, an examination was made of

Colonial American Life Insurance Company, NAIC Code: 73326,

a Pennsylvania domiciled stock life, accident and health insurance company, hereinafter referred to as "Company" or "Colonial". The examination was conducted at the Company's home office, located at 673 Cherry Lane, Souderton, Pennsylvania 18964-0477.

A report of this examination is hereby respectfully submitted.

SCOPE OF EXAMINATION

The Company was last examined as of December 31, 2003.

This examination covered the five-year period from January 1, 2004 through December 31, 2008, and consisted of a general survey of the Company's business practices and management, and an evaluation of the Company's financial condition as of the latter date. Material subsequent events were also reviewed.

Colonial American Life Insurance Company

-2-

Work programs employed in the performance of this examination were designed to comply with the standards promulgated by the Pennsylvania Insurance Department ("Department") and the National Association of Insurance Commissioners ("NAIC").

The format of this report is consistent with the current practices of the Department and the examination format prescribed by the NAIC. It is limited to a description of the Company, a discussion of financial items that are of specific regulatory concern, and a factual disclosure of other significant regulatory information.

For each year during the period under examination, the Certified Public Accounting ("CPA") firm of Beard Miller Company, LLP, Malvern, Pennsylvania, has provided an unqualified opinion based on statutory accounting principles. Relevant work performed by the CPA firm, during its annual audit of the Company, was reviewed during the examination and incorporated into the examination workpapers.

HISTORY

The Company was incorporated on September 1, 1924, as a Louisiana industrial life insurance company named Douglas Life Insurance Company. On September 18, 1967, the Company converted to an ordinary life insurer, and on May 18, 1983, it was sold to Fleet Financial Group, Inc.

On January 31, 1997, the Company was purchased with management and control acquired by United Security Assurance Company of Pennsylvania, a Pennsylvania domestic stock casualty insurance company. The Company was issued a Certificate of Authority by the Department to operate as a foreign insurance company on January 22, 1998, and it redomesticated to Pennsylvania as a domestic insurance corporation on October 13, 1998.

The Company is currently authorized to transact those classes of insurance described in the Pennsylvania Insurance Company Law 40 P.S. § 382, Section 202, Subsection (a), Paragraphs (1) Life and Annuities and (2) Accident and Health.

MANAGEMENT AND CONTROL

CAPITALIZATION

As of the examination date, December 31, 2008, the Company's total capital and surplus was \$4,541,979, consisting of 1,100,000 shares of issued and outstanding common stock with a par value of \$1.00 per share amounting to \$1,100,000; \$ 3,025,000 in paid in and contributed surplus; and \$416,979 in unassigned funds.

Colonial American Life Insurance Company

-3-

The total capital and surplus required of the Company, to engage in the types of business for which it is licensed, is \$1,100,000 in capital and \$550,000 in surplus. The Company meets this requirement.

STOCKHOLDER

The Company is a wholly owned subsidiary of United Security Assurance Company of Pennsylvania, a Pennsylvania domestic stock insurance company. The Company issued a Cash dividend of \$7,200,000 in 2008 as part of a reinsurance agreement with its parent to assume its entire book of business. The 2008 cash dividend was extraordinary. Prior approval was obtained from the Department.

INSURANCE HOLDING COMPANY SYSTEM

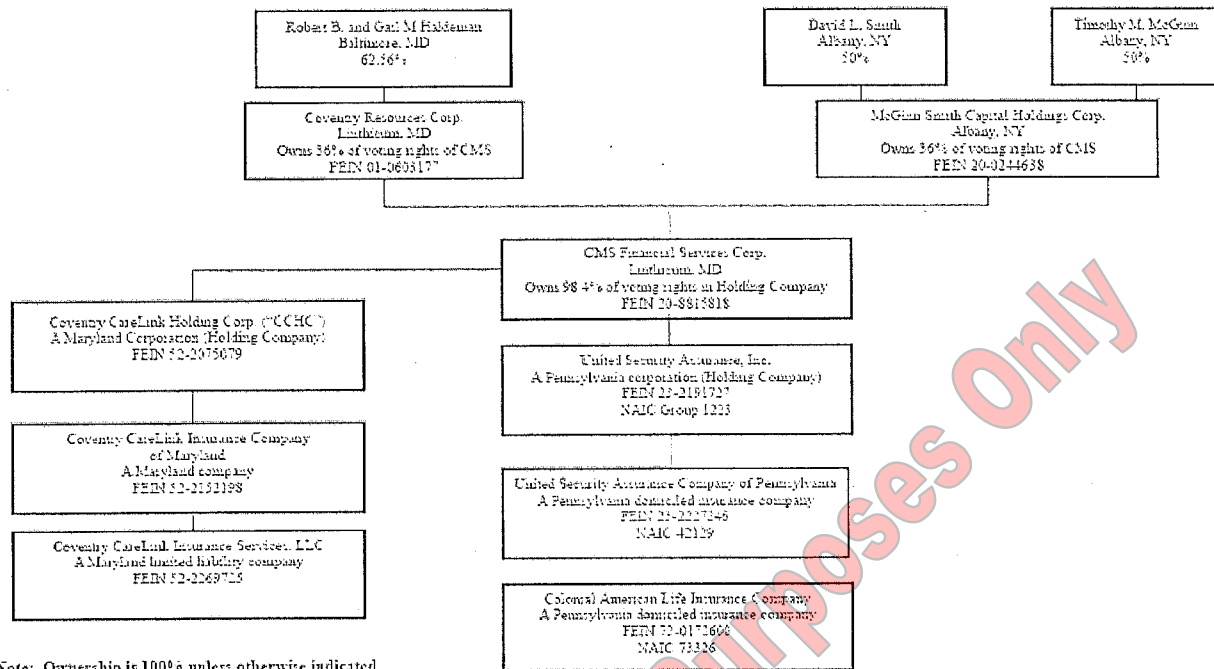
The Company is a member of an Insurance Holding Company System and meets the requirements for filing an Insurance Holding Company System Registration Statement, in accordance with Pennsylvania Insurance Company Law 40 P.S. §§ 991.1401-991.1413. An Insurance Holding Company System Registration Statement was filed on behalf of the Company and the other insurance company in the holding company system by CMS Financial Services Corp. the parent and ultimate controlling entity in the system.

The Company is owned 100% by United Security Assurance Company of Pennsylvania. United Security Assurance Company of Pennsylvania is owned 100% by United Security Assurance, Inc, which is in turn owned by CMS Financial Services Corp. CMS Financial Services Corp. is owned 36% by Coventry Resources Corp, which is owned 62.56% by Robert B. and Gail M. Haldeman, and 36% by McGinn Smith Capital Holdings Corp, which is owned 50% each by David L. Smith and Timothy M. McGinn. There are no other individuals that own a controlling share of any of these entities.

The following is the Company's corporate structure as of December 31, 2008:

Colonial American Life Insurance Company

-4-



A description of the function of each company is as follows:

- Colonial American Life Insurance Company (“CALIC”), a Pennsylvania domiciled insurance Company.
- United Security Assurance Company of Pennsylvania (“USAC”), a Pennsylvania domiciled insurance Company, owning 100% of CALIC.
- United Security Assurance, Inc. (“USAI”), a Pennsylvania domiciled corporation, operates as an intermediate level holding company, owning 100% of the outstanding capital stock of the Company. USAI provides real estate administrative services to USAC under a Service Contract.
- CMS Financial Services Corp. (“CMS”), a Maryland domiciled corporation, operates as an intermediate level holding company, owning 98.4% of the outstanding capital stock of USAI. CMS provides administrative services to USAC under a Service Contract.
- Coventry CareLink Insurance Services, LLC (“CCIS”), a Maryland domiciled company, operates as a licensed Third-Party Administrator. CCIS performs some underwriting, premium billing, and claims management services to USAC.
- Coventry CareLink Insurance Company of Maryland (“CCIC”), a Maryland domiciled corporation, operates as an intermediate level holding company, is the sole member of CCIS. CCIC was licensed as an insurance company in the state of Maryland, but has since surrendered its license.
- Coventry CareLink Holding Corp. (“CCHC”), a Maryland domiciled corporation, operates as an intermediate level holding company, owning 100% of the outstanding capital stock of

Colonial American Life Insurance Company

-5-

CCIC.

- Coventry Resources Corp. is a Maryland domiciled company that operates as a capital holding corporation.
- McGinn Smith Capital Holdings Corp. is a New York domiciled company that operates as a capital holding corporation.

During the period under examination, the Company did not properly recognize Coventry CareLink Holding Company and its subsidiaries as affiliated entities in its reporting and disclosures. Prior to the end of fieldwork, the Company started recognizing Coventry CareLink Holding Company as an affiliate in some of its filings and disclosures.

It is recommended that the Company comply with the NAIC Annual Statement Filing Instructions and Pennsylvania's Insurance Holding Company Law and properly recognize and report its subsidiaries as affiliated entities on all of its filings and disclosures.

BOARD OF DIRECTORS

Management of the Company is vested in its Board of Directors ("Board"), which was comprised of the following members as of the examination date, December 31, 2008:

Name and Address	Principal Occupation
Robert Berry Haldeman Baltimore, Maryland	Co-Chief Executive Officer CMS Financial Services Corp.
Timothy Michael Kolojay Hopkinton, New Hampshire	Co-Chief Executive Officer CMS Financial Services Corp.
Gregory Scott Landes* Telford, Pennsylvania	Independent Insurance Agent
Ronald A. Landes* Telford, Pennsylvania	President RAL Associates, Inc
Cleaveland Dale Miller* Baltimore, Maryland	Partner Semmes, Bowen & Semmes
William Jay Neugroschel Ellicott City, Maryland	President and Chief Executive Officer United Security Assurance Company of Pennsylvania
Martha Cecelia Stephens Media, Pennsylvania	Vice President, Operations United Security Assurance Company of Pennsylvania
Cecelia Mary Zbyszinski North Wales, Pennsylvania	Vice President and Corporate Secretary United Security Assurance Company of Pennsylvania

Colonial American Life Insurance Company

-6-

John Charles Wilkin*
Ellicott City, Maryland

Senior Actuary
Actuarial Research Corporation

* Independent committee members

The Company has three classes of directors, with a different class elected every year. The directors serve a three-year term. The Company has a written Conflict of Interest Disclosure Statement and an Acceptance of Trust that each director and officer is required to sign annually.

The Company shares a common directorship with its parent, United Security Assurance Company of Pennsylvania.

The Pennsylvania Insurance Company Law, 40 P.S. § 991.1405 Section (c), Paragraph (3), requires that no less than one-third of the directors on the Company's Board and not less than one-third of the members on any committee of the Board be persons who are not officers or employees of the Company or any entity controlling, controlled by or under common control with the Company and who are not beneficial owners of a controlling interest in any quorum for the transaction of business at any meeting of the Board or any committee thereof. The Company was in compliance with these requirements.

Further the Company has a committee comprised solely of directors who are not officers or employees of the Company or any entity controlling, controlled by or under common control with the Company and who are not beneficial owners of a controlling interest in the voting stock of the Company or any such entity. The committee is charged with the responsibilities for recommending the selection of the Company's independent outside auditors, and external actuaries, recommending the compensation of officers and nominating candidates for election of directors by the shareholders, as required by Pennsylvania Insurance Company Law, 40 P.S. § 991.1405 Section (c), Paragraph (4).

Except for the keeping of committee minutes (See "Minutes" below), the Board and the independent committee of the Board were acting in accordance with the By-laws of the Company.

OFFICERS

As of the examination date, December 31, 2008, the following officers were appointed and serving in accordance with the Company's By-laws:

Name	Title
William Jay Neugroschel	Chief Executive Officer/President
Martha Cecelia Stephens	Vice President Operations
Richard Gramm	Treasurer
Cecelia Mary Zbyszinski	Secretary

CORPORATE RECORDS

MINUTES

A compliance review of the Company's corporate minutes indicated the following:

- The Annual Stockholders' Meetings were held in compliance with the Company's By-laws;
- The members of the Board were elected at the Annual Stockholders' Meeting in compliance with the Company's By-laws;
- Quorums were present at all Stockholders' Directors' and committee meetings;
- The actions of the Company's directors and officers were ratified by the Company's stockholders;
- The Company's officers were appointed at the Annual Organizational Meeting of the Board of Directors;
- The Company's investment and reinsurance transactions were approved by the Board of Directors or a committee thereof;
- The actions of the Investment Committee were ratified regularly by the Board of Directors;
- All directors regularly attended Board Meetings.

In reviewing the minutes of the Board of Directors, it was noted that the Compensation, Actuarial and Auditing Nomination Committee ("C.A.A.N.S."), an independent committee, did not keep minutes of its meetings during the period under examination. It was also noted that the Investment Committee did not keep minutes during the period under examination. Keeping accurate records of all official proceedings of board of directors and committees is required by Pennsylvania Business Corporation Law 15 Pa. C.S. § 1508(a), which states: "Required records. - Every business corporation shall keep complete and accurate books and records of account, minutes of the proceedings of the incorporators, shareholders, and directors and a share register giving the names and addresses of all shareholders and the number and class of shares held by each." In addition, the Company's By-laws Article X Section 1 states: "The company shall keep at its principal office an original or duplicate copy of the proceedings of the stockholders and of the directors; the original or a copy of its By-laws, including all amendments and alterations thereto to date, certified by the Secretary; and a stock book or register; and complete and accurate books or records of account." Committee meetings are considered proceedings of the directors.

Colonial American Life Insurance Company

-8-

Prior to completion of exam work, the Company started maintaining records for the meetings of all subsequent C.A.A.N.S. Meetings and Investment Committee Meetings.

ARTICLES OF INCORPORATION

There were no amendments to the Company's Articles of Incorporation during the examination period.

BY-LAWS

The By-laws were amended in January of 2008 to change the date of Stockholders' meetings from June to September. The By-laws were amended again in April 2008 to replace a specific reference to a Pennsylvania Insurance Law with a general reference to Pennsylvania Insurance Laws. These changes were reported to the Department and properly disclosed in the General Interrogatories to the Annual Statements.

SERVICE AND OPERATING AGREEMENTS

The Company had the following agreements in effect during the examination period:

Management Agreement with CMS Financial Services Corp.

A management agreement with the new ultimate controlling company, CMS Financial Services Corp., went into effect with the Company and its parent, United Security Assurance Company of Pennsylvania, on October 9, 2007. CMS will provide various administrative and actuarial services to USAC and Colonial, including:

- Operational Process Development
- Regulatory Procedures Development
- General Management Services
- Actuarial and Financial Services Forecasting
- Information Technology services
- Reinsurance Services
- Master Contract Services
- Credit Rating Improvement
- Financial Oversight, Reporting, and Budgeting
- Facilities Negotiations

This agreement is not in compliance with SSAP No. 25, Paragraph 6, as amended by SSAP No. 98, and 40 P.S. § 991.1405 because the agreement doesn't provide for timely settlement of amounts owed, with a specific due date. Also, this agreement is not in compliance with 40 P.S. § 991.1405 because it does not have a provision for penalties for late payment.

Colonial American Life Insurance Company

-9-

It is recommended that the Company amend the Management Agreement between CMS Financial Services Corp, United Security Assurance Company of Pennsylvania, and Colonial American Life Insurance Company for the administration of general management, financial, actuarial and IT services to comply with SSAP No. 25, as amended by SSAP No. 98, and 40 P.S. § 991.1405 by adding provisions for timely settlement of amounts owed, with a specific due date, and a provision for penalties for late payment.

Expense Sharing Agreement with USAC

An expense sharing agreement with the immediate parent, USAC, went into effect with the Company, on October 9, 2007. CALIC will pay USAC a portion of the expenses to be accrued and calculated based on Colonial's direct written premium. This amount is approved by the Board annually. Colonial no longer writes business; however, services are still performed for Colonial (such as the processing of investments, reporting, and accounting).

This agreement was not in compliance with 40 P.S. § 991.1405 because it does not have a provision for penalties for late payment and with SSAP No. 25, Paragraph 6, as amended by SSAP No. 98, and 40 P.S. § 991.1405 because the agreement doesn't provide for timely settlement of amounts owed, with a specific due date.

During examination fieldwork, the Company amended this agreement effective January 1, 2009. The amended agreement fixes the terms of the agreement, adds a penalty clause for late payment, and reflects a specific due date.

REINSURANCE

CEDED

Currently, the Company does not cede insurance business.

ASSUMED

On December 31, 2008, the Company amended the agreement between CALIC and London Life Reinsurance Company to change the retrocessionaire of the agreement from CALIC back to the USAC. Currently, the Company does not assume insurance business.

Colonial American Life Insurance Company

-10-

TERRITORY AND PLAN OF OPERATIONS

The Company is licensed and wrote business in the following jurisdictions:

Florida
Mississippi
South Carolina

Louisiana
Pennsylvania
Texas

During 2008, the Company's direct written premium totaled \$4,930,019, with \$2,768,558 or 56.2% written in Florida and \$1,664,121 or 33.8% written in Texas.

The Company primarily writes Long-Term Care policies and Home Health Care policies. In addition, the Company also writes small life policies. The following chart summarizes the Company's direct and assumed, ceded and net written premiums for the year 2008:

Line of Business	Direct and Assumed Premium	Ceded Premium	Net Premium	Percentage of Total
Ordinary life	\$ 227,250	\$ 0	\$ 227,250	4.0 %
Other accident and health	5,473,761	-	5,473,761	96.0 %
Totals	<u>\$ 5,701,011</u>	<u>\$ 0</u>	<u>\$ 5,701,011</u>	<u>100.0 %</u>

No lines of business are showing significant adverse experience. The Company's utilizes a network of independent agents to solicit business.

SIGNIFICANT OPERATING TRENDS

The following indicates the growth of the Company during the period covered by this examination:

	2008	2007	2006	2005	2004
Admitted Assets	\$ 4,546,446	\$ 26,535,537	\$ 24,480,010	\$ 22,257,983	\$ 19,937,626
Liabilities	\$ 4,467	\$ 16,299,212	\$ 15,534,459	\$ 14,123,056	\$ 12,865,738
Capital and Surplus Funds	\$ 4,541,979	\$ 10,236,325	\$ 8,945,551	\$ 8,134,927	\$ 7,071,888
Net Premiums Written	\$ 5,701,011	\$ 5,495,090	\$ 5,181,476	\$ 5,053,052	\$ 4,464,680
Benefits to Members	\$ 1,446,101	\$ 1,933,623	\$ 2,039,773	\$ 1,879,637	\$ 2,051,364
Net Investment Income	\$ 835,432	\$ 738,606	\$ 632,314	\$ 520,705	\$ 458,694
Net Income	\$ 1,675,945	\$ 1,203,240	\$ 619,528	\$ 1,064,651	\$ 362,229

Since the prior examination, the Company experienced the following changes in its total number of certificates in force, the overall amount of insurance in force, and the average amount of insurance in force per policy:

Colonial American Life Insurance Company

-11-

	Certificates In Force	Insurance In Force	Average Policy In Force
Ordinary Life			
December 31, 2008	0	\$ 0	\$ 0
December 31, 2003	440	3,060,700	6,956
Net Increase/(decrease)	<u>(440)</u>	<u>\$ (3,060,700)</u>	<u>\$ (6,956)</u>
Ordinary Accident and Health			
December 31, 2008	0	\$ 0	\$ 0
December 31, 2003	2,776	3,762,492	1,355
Net Increase/(decrease)	<u>(2,776)</u>	<u>\$ (3,762,492)</u>	<u>\$ (1,355)</u>

In 2008, the Company ceded its entire book of business to its parent United Security Assurance Company of Pennsylvania.

ACCOUNTS AND RECORDS

The Company's accounting, investment, policy and claim records are maintained and kept at the Company's home office located in Souderton, Pennsylvania. All of the Company's information systems resources are owned by United Security Assurance, Inc., an upstream holding company.

The Company's general ledger accounting application is Peachtree Software's Peachtree Accounting Release 12. Policy issue, premium processing, billing, claim processing, and payment functions are handled by a proprietary application developed by the Company's former consulting actuary, Gerald J. Rankin and Associates. The insurance administration application was developed in R/BASIC utilizing a backend Advanced Revelation, Version 2.1, database management system. Workstations are Windows based personal computers, using Windows 98 or Windows XP, with most employees using Microsoft Office for word processing and/or for spreadsheets.

The Company uses an internal local area network with no external connections, and its network server is a Compaq Proliant ML350 Network Server, with a Novell NetWare 5.1 operating system for accounting and operations and a Dell Power Edge 830 Server, with Windows Server 2003 Small Business operating system, for sales and marketing activities, e-mail and internet access. Independent consultants are used for network upgrades and service, with services also provided by Jeb Bonsteel, the Director of IT for affiliates CCIS/CMS.

PENDING LITIGATION

The Company was not involved in any pending or ongoing litigation of a significant nature.

FINANCIAL STATEMENTS

The financial condition of the Company, as of December 31, 2008, and the results of its operations for the five-year period under examination, are reflected in the following statements:

Comparative Statement of Assets, Liabilities, Surplus and Other Funds;
Comparative Statement of Income;
Comparative Statement of Capital and Surplus; and
Comparative Statement of Cash Flow

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Colonial American Life Insurance Company

-13-

Comparative Statement of Assets, Liabilities, Surplus and Other Funds
As of December 31,

	2008	2007	2006	2005	2004
Bonds	\$ 2,444,932	\$ 14,919,496	\$ 12,887,022	\$ 11,163,061	\$ 9,057,280
Cash, cash equivalents and short-term investments	1,417,669	1,228,112	1,403,586	1,545,105	1,722,499
Contract loans	0	13,114	4,747	5,225	1,075
Subtotal, cash and invested assets	3,862,601	16,160,722	14,295,355	12,713,391	10,780,854
Investment income due and accrued	22,352	163,072	152,881	133,424	104,265
Premiums and considerations	0	83,101	84,527	75,775	70,204
Funds held by or deposited with reinsured companies	0	9,868,208	9,697,586	9,322,860	8,956,267
Current federal and foreign income tax recoverable and interest thereon	235,670	0	66,499	0	8,406
Net deferred tax asset	0	256,014	175,604	0	0
Receivable from parent, subsidiaries and affiliates	425,823	0	0	0	0
Health care and other amounts receivable	0	4,420	4,377	8,537	5,338
Aggregate write-ins for other than invested assets	0	0	3,181	3,996	12,272
Total	\$ 4,546,446	\$ 26,535,537	\$ 24,480,010	\$ 22,257,983	\$ 19,937,626
Aggregate reserve for life contracts	\$ 0	\$ 559,501	\$ 518,072	\$ 434,851	\$ 357,337
Aggregate reserve for accident and health contracts	0	14,567,145	13,484,755	12,130,048	11,312,722
Contract claims:					
Life	0	25,000	44,000	13,000	12,000
Accident and health	0	793,203	1,148,836	1,025,177	870,365
Commissions to agents due or accrued	0	405	884	606	0
Commissions and expense allowances payable on reinsurance assumed	0	1,026	8,872	13,859	14,234
General expenses due or accrued	0	50,381	87,135	88,936	66,027
Taxes, licenses and fees due or accrued	0	38,102	29,695	44,927	32,192
Federal income taxes due or accrued	0	98,480	0	159,502	0
Amounts held for agents' account	0	66,573	60,679	64,788	62,074
Remittances and items not allocated	0	37,399	51,194	80,276	79,896
Miscellaneous liabilities:					
Asset valuation reserve	4,467	4,581	1,687	1,826	1,841
Payable to parent, subsidiaries and affiliates	0	37,416	99,050	65,260	57,050
Total liabilities	4,467	16,299,212	15,534,459	14,123,056	12,865,738
Common capital stock	1,100,000	1,100,000	1,100,000	1,100,000	1,100,000
Gross paid in and contributed surplus	3,025,000	3,025,000	3,025,000	3,025,000	3,025,000
Unassigned funds (surplus)	416,979	6,111,325	4,820,551	4,009,927	2,946,888
Surplus	3,441,979	9,136,325	7,845,551	7,034,927	5,971,888
Total capital and surplus	4,541,979	10,236,325	8,945,551	8,134,927	7,071,888
Totals	\$ 4,546,446	\$ 26,535,537	\$ 24,480,010	\$ 22,257,983	\$ 19,937,626

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Colonial American Life Insurance Company

-14-

Comparative Statement of Income
For the Year Ended December 31,

	2008	2007	2006	2005	2004
Premiums and annuity considerations for life and A&H contracts	\$ 5,701,011	\$ 5,495,090	\$ 5,181,476	\$ 5,053,052	\$ 4,464,680
Net investment income	835,432	738,606	632,314	520,705	458,694
Amortization of interest maintenance reserve (IMR)	(506)	(492)	0	0	0
Miscellaneous Income:					
Aggregate write-ins for miscellaneous income	536,419	564,067	572,831	530,251	603,150
Totals	7,072,356	6,797,291	6,386,621	6,104,008	5,526,524
Death benefits	128,338	149,488	128,681	65,170	72,312
Disability benefits and benefits under accident and health contracts	1,309,436	1,775,886	1,897,222	1,809,034	1,969,311
Surrender benefits and withdrawals for life contracts	8,327	8,249	13,870	5,433	9,741
Increase in aggregate reserves for life and A&H policies and contracts	650,249	1,143,819	1,437,928	894,840	1,097,775
Totals	2,096,350	3,077,442	3,477,701	2,774,477	3,149,139
Commissions on premiums, annuity considerations & deposit-type funds (direct)	1,349,368	1,178,894	1,104,317	1,176,720	1,180,361
Commissions and expenses allowances on reinsurance assumed	122,628	137,716	158,866	180,087	189,731
General insurance expenses	1,757,312	732,653	617,164	462,235	395,790
Insurance taxes, licenses and fees	121,323	139,936	119,268	132,480	110,817
Increase in loading on deferred and uncollected premiums	(1,420)	(17,806)	14,458	(221)	(3,172)
Totals	5,445,561	5,248,835	5,491,774	4,725,778	5,023,666
Net gain from operations after dividends to policyholders and before federal income taxes	1,628,795	1,548,456	894,847	1,378,230	502,858
Federal income taxes incurred (excluding tax on capital gains)	(49,150)	344,680	275,319	313,579	140,629
Net gain from operations after dividends to policyholders and federal income taxes and before realized capital gains or (losses)	1,675,945	1,203,776	619,528	1,064,651	362,229
Net realized capital gains or (losses) less capital gains tax (excluding gains/losses transferred to the IMR)	0	(536)	0	0	0
Net income	\$ 1,675,945	\$ 1,203,240	\$ 619,528	\$ 1,064,651	\$ 362,229

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Colonial American Life Insurance Company

-15-

**Comparative Statement of Capital and Surplus
For the Year Ended December 31,**

	2008	2007	2006	2005	2004
Capital and surplus, December 31, previous year	\$ 10,236,325	\$ 8,945,551	\$ 8,134,927	\$ 7,071,888	\$ 6,677,697
Net income	1,675,945	1,203,240	619,528	1,064,651	362,229
Change in net deferred income tax	(895,636)	17,961	472,036	111,153	71,489
Change in nonadmitted assets and related items	725,230	72,468	(281,080)	(112,780)	(39,491)
Change in asset valuation reserve	115	(2,895)	140	15	(36)
Dividends to stockholders	(7,200,000)	0	0	0	0
Net change in capital and surplus for the year	(5,694,346)	1,290,774	810,624	1,063,039	394,191
Capital and surplus, December 31, current year	\$ 4,541,979	\$ 10,236,325	\$ 8,945,551	\$ 8,134,927	\$ 7,071,888

For Informational Purposes Only

Colonial American Life Insurance Company

-16-

Comparative Statement of Cash Flow
For the Year Ended December 31,

	2008	2007	2006	2005	2004
Cash from Operations					
Premiums collected net of reinsurance	\$ 5,785,532	\$ 5,514,322	\$ 5,158,266	\$ 5,047,702	\$ 4,457,970
Net investment income	966,132	736,948	614,236	491,458	452,624
Miscellaneous income	10,404,627	393,465	198,105	163,658	409,715
Total	17,156,291	6,644,735	5,970,607	5,702,818	5,320,309
Benefit and Loss related Payments	18,061,199	2,308,056	1,885,314	1,747,725	1,735,503
Commissions, expenses paid and aggregate write-ins for deductions	3,429,047	2,233,267	2,021,966	1,892,420	1,896,062
Federal and foreign income taxes paid (recovered)	285,001	179,701	501,320	145,671	115,035
Total deductions	21,775,247	4,721,024	4,408,600	3,785,816	3,746,600
Net Cash from Operations	(4,618,956)	1,923,711	1,562,007	1,917,002	1,573,709
Cash from Investments					
Proceeds from investments sold, matured or repaid:					
Bonds	22,545,294	3,689,492	1,229,000	1,795,000	3,937,761
Total investment proceeds	22,545,294	3,689,492	1,229,000	1,795,000	3,937,761
Cost of investments acquired (long-term only):					
Miscellaneous applications	0	0	0	0	1,437
Total investments acquired	10,072,208	5,724,437	2,953,931	3,900,000	4,525,125
Net increase (decrease) in policy loans and premium notes	(13,114)	8,367	(478)	4,150	1,075
Net cash from investments	12,466,200	(2,043,312)	(1,724,453)	(2,109,150)	(588,439)
Cash from Financing and Miscellaneous Sources					
Cash provided (applied):					
Dividends to stockholders (paid)	(7,200,000)	0	0	0	0
Other cash provided or (applied)	(477,687)	(55,873)	20,927	14,754	(56,247)
Net cash from financing and miscellaneous sources	(7,677,687)	(55,873)	20,927	14,754	(56,247)
Reconciliation of cash and short-term investments:					
Net change in cash and short-term investments	189,557	(175,474)	(141,519)	(177,394)	929,023
Cash and short-term investments:					
Beginning of the year	1,228,112	1,403,586	1,545,105	1,722,499	793,476
End of the year	\$ 1,417,669	\$ 1,228,112	\$ 1,403,586	\$ 1,545,105	\$ 1,722,499

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SUMMARY OF EXAMINATION CHANGES

No changes were made to the Company's financial statements as a result of this examination.

NOTES TO FINANCIAL STATEMENTS

INVESTMENTS

As of December 31, 2008, the Company's invested assets were distributed as follows:

	Amount	Percentage
Bonds	\$ 2,444,932	63.3 %
Cash	770,754	20.0 %
Short-term investments	646,915	16.7 %
Totals	\$ 3,862,601	100.0 %

The Company's bond and short-term investment portfolio had the following quality and maturity profiles:

NAIC Designation	Amount	Percentage
1 - highest quality	\$ 3,091,847	100.0 %
Totals	\$ 3,091,847	100.0 %

Years to Maturity	Amount	Percentage
1 year or less	\$ 1,547,499	50.1 %
2 to 5 years	552,499	17.9 %
6 to 10 years	991,849	32.0 %
Totals	\$ 3,091,847	100.0 %

As shown above, the Company's invested assets are primarily concentrated in a portfolio of high quality bonds, comprising 63.3% of the Company's total invested assets.

The primary goal of the Company's investment portfolio is to obtain a favorable return on invested assets representing policy reserves, capital and surplus through investment in high quality income-producing and long-term capital growth oriented assets. Listed below are the primary objectives of the investment portfolio:

- To ensure sufficient cash flow and liquidity to fund expected liability payments and otherwise support the Company's operations. The Company recognizes the need for

Colonial American Life Insurance Company

-18-

flexibility to manage assets to improve investment returns; however, also sees potential benefits from lowering the risk of forced asset sales in adverse market conditions.

- To preserve and grow capital and surplus in order to improve the Company's competitive position and allow for expansion of insurance operations. Stability and growth of investment income are viewed as critical to assuring a high probability of steady growth in capital.
- Subject to achieving the first two objectives, pursue as high a level of income and return as is consistent with these guidelines, in order to enhance the Company's competitive position and economic value. There is a decided preference toward capturing return in the form of net investment income rather than in the form of capital gains.

The Company utilizes an external independent professional investment manager, Conning Asset Management Company, to manage its investment portfolio.

The Company's investment portfolio of bonds, stocks, and short-term investments, during the period of the examination, was held under a custodial agreement with Univest Bank and Trust that did not require CUSIP numbers on reports and was deemed not in compliance with 31 Pa. Code § 148a.3. The custodial agreement was amended during the examination and is now in compliance with 31 Pa. Code § 148a.3.

The Company has a written investment policy as required by the Pennsylvania Insurance Company Law 40 P.S. § 504.1. The investment policy is reviewed and approved, on an annual basis, by the Board of Directors. The Company, at December 31, 2008, was following its investment policy.

The Company had an informal Other-Than-Temporary Impairment Policy ("OTTP"). Before the end of fieldwork, the Company formalized their OTTI policy. Therefore, no recommendation to formalize this policy will be made. The Company did not record impairments on investments held as of December 31, 2008.

POLICYHOLDER AND CLAIM RESERVES

In 2008, the Company ceded 100% of its book of business to its parent, United Security Assurance Company of Pennsylvania. Policyholder and Claim Reserves transferred to USAC as of December 31, 2008 were developed by an independent actuarial firm, Milliman, Inc., who provided a clean opinion as to the Company's Policyholder and Claim Reserves.

As part of this examination, the Department's Office of Rate and Policy regulation, Life Bureau, Actuarial Review Division, reviewed the USAC's valuation filing in support of its reported reserves. This analysis was performed in accordance with the Department's established accident and health reserve valuation procedures. There were no material recommendations or adjustments to the Company's reserves as a result of the review.

Colonial American Life Insurance Company

-19-

In addition, the examination included sampling of the Company's detailed policy and claims records to test the accuracy and completeness of the underlying data supporting the Company's reserves.

SUBSEQUENT EVENTS

GOVERNANCE

As a subsequent event, a Stock Exchange Agreement was entered into by CRC and McGinn Smith Capital Holdings Corp. reducing the effective ownership of McGinn Smith Capital Holdings Corp (and therefore the percentage ownership of David L. Smith and Timothy M. McGinn) below the 10% threshold.

On December 31, 2008, Timothy M. Kolojay resigned as Co-Chief Executive Officer of CMS Financial Services Corp., but retained his membership on the Board of Directors for CMS Financial Services Corp., United Security Assurance Company of Pennsylvania, and Colonial American Life Insurance Company, effectively becoming an independent board member.

During the examination, Richard Gramm passed away unexpectedly. He was replaced by Sandra Kegley as Treasurer in July of 2009.

OTHER THAN TEMPORARY IMPAIRMENT

The Company did not record impairments on investments held as of December 31, 2008, subsequent to the examination report.

MOST RECENT FINANCIAL STATEMENT HIGHLIGHTS

The Company reflected the following in its December 31, 2009 Annual Statements: total assets equaled \$4,554,733, total liabilities equaled \$5,624, surplus equaled \$3,449,109, and the Company experienced a net gain from operations of \$7,278. These figures were not verified as part of the examination and are included for information purposes only.

RECOMMENDATIONS

PRIOR EXAMINATION

The prior examination report contained the following recommendations:

1. It was recommended that the Company file with the Department's Office of Rate and Policy Regulation, Life Bureau, Actuarial Review Division for review prior to

Colonial American Life Insurance Company

-20-

implementation, any planned modifications in valuation claims costs, margins, or other assumptions used in statutory reserve calculations.

The Company has complied with this recommendation.

CURRENT EXAMINATION

As a result of the current examination, the following recommendations are being made:

1. It is recommended that the Company comply with the NAIC Annual Statement Filing Instructions and Pennsylvania's Insurance Holding Company Law and properly recognize and report its subsidiaries as affiliated entities on all of its filings and disclosures (see "Insurance Holding Company System", page 5).
2. It is recommended that the Company amend the Management Agreement between CMS Financial Services Corp, United Security Assurance Company of Pennsylvania, and Colonial American Life Insurance Company for the administration of general management, financial, actuarial and IT services to comply with SSAP No. 25, as amended by SSAP No. 98, and 40 P.S. § 991.1405 by adding provisions for timely settlement of amounts owed, with a specific due date, and a provision for penalties for late payment (see "Service and Operating Agreements" page 9).

CONCLUSION

As a result of this examination, the financial condition of Colonial American Life Insurance Company, as of December 31, 2008, was determined to be as follows:

	Amount	Percentage
Admitted assets	\$ 4,546,446	100.0 %
Liabilities	\$ 4,467	0.1 %
Capital and Surplus	4,541,979	99.9 %
Total liabilities, capital and surplus	\$ 4,546,446	100.0 %

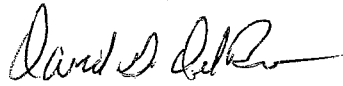
Since the previous examination, made as of December 31, 2003, the Company's assets decreased by \$13,687,646, its liabilities decreased by \$11,551,928, and its surplus decreased by \$2,135,718.

Colonial American Life Insurance Company

-21-

This examination was conducted by Stephanie Norris, CFE, William Umbaugh, CFE, and Keith D. Wandel, Jr., CFE, with the latter in charge.

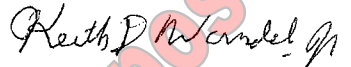
Respectfully



David G. DelBiondo, CPA
Director, Bureau of Examinations



Joseph Jacobs, CFE
Examination Manager



Keith D. Wandel, Jr., CFE
Examiner-In-Charge

The CFE designation has been conferred by an organization not affiliated with the federal or any state government. However the CFE designation is the only designation recognized by the NAIC for the purposes of directing statutory Association examinations of insurance companies.

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