Report

of the

Examination of

Aid Association for Lutherans

Appleton, Wisconsin

As of December 31, 1999

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September 1, 2000

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Commissioners:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

AID ASSOCIATION FOR LUTHERANS
Appleton, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the society was conducted in 1995 as of December 31, 1994. The current examination covered the intervening period ending December 31, 1999, and included a review of such 2000 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the society's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employes' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Society
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the society's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the society to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the society's operations is contained in the examination work papers.

The society is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

Independent actuaries were engaged under a contract with the Office of the Commissioner of Insurance. They reviewed the adequacy of aggregate life and accident and health reserves, refunds to members, cash flow testing, deferred and uncollected premiums for

life insurance, due and uncollected premiums for health insurance, and in-force testing. The results of their work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuaries' conclusion.

II. HISTORY AND PLAN OF OPERATION

Aid Association for Lutherans (hereinafter also “AAL” or “the society”) was organized November 24, 1902, under the Wisconsin laws applicable to fraternal benefit societies. The society offers a broad range of financial products and fraternal benefits to its members and other Lutherans.

The society is licensed to write insurance in all 50 states and the District of Columbia. The states with the most direct premiums written in 1999 were as follows:

Wisconsin	13%
Minnesota	9
Illinois	8
Michigan	6
California	5
Texas	5
All others	54
	100%

The major products marketed by the society include flexible and single premium retirement (deferred) annuities and single premium immediate annuities, traditional and universal life insurance, as well as disability income, long-term care, and Medicare supplement insurance.

In 1994, the board of directors authorized the establishment of a separate account for variable annuity contracts. The society’s certificate of authority was amended to add variable annuities in Wisconsin and several other states, and sales of a flexible-premium deferred variable annuity contract began in June 1995. Purchasers may choose to invest in one or more of six fund options. This has become one of its major products for the society.

The society's products are marketed through 1,642 full-time and 77 associate (part-time) agents called district representatives (DRs). The DRs are under contract with AAL to sell for AAL, and must also meet the conditions of benefit membership. AAL assigns the DRs a set of Lutheran congregations to serve, and these sales territories are closed to selling activity by other DRs. DRs also serve as advisors to local branches, which are groups of society members at the local level who unite to do charitable, educational, and social activities. The society had 10,223 local branches at year-end 1999.

DRs are organized into general agencies and report to a general agent. There were 44 general agents at the end of 1999. The general agencies are organized into seven regions and each general agent reports to one of two field leadership positions.

Commissions paid to DRs range from 1% on annuities to 76% on universal life products. General agents receive compensation based on sales.

The following chart is a summary of the net insurance premiums written by the society in 1999. The growth of the society is discussed in the Financial Data section of this report.

Line of Business	**Direct Premium**	**Reinsurance Ceded**	**Net Premium**
Traditional life	$213,110,855	$8,143,158	$204,967,698
Universal life	396,370,978	1,577,930	394,793,048
Fixed annuity	428,236,584	0	428,236,584
Variable annuity	397,878,074	0	397,878,074
Accident and health	157,881,909	23,138	157,858,770
Total All Lines	$1,593,478,400	$9,744,226	$1,583,734,174

III. MANAGEMENT AND CONTROL

Membership

The articles of incorporation of the society provide for three classes of members: benefit, associate, and youth members. A benefit member is a person age 16 or more who has been accepted for membership in accordance with eligibility rules as determined by resolution of the board of directors and who is the applicant member on a certificate of membership and insurance pursuant to rules determined by resolution of the board of directors, or who receives a settlement agreement by virtue of such insurance. An associate member is a person age 16 or more who has been accepted for membership in accordance with eligibility rules as determined by resolution of the board of directors and who is issued a certificate of membership. A youth member is a person under age 16 that is eligible for membership and has been issued a certificate of membership or a certificate of membership and insurance.

The society's articles provide that all members may participate in the affairs and activities of the local branch in which they are members. Either benefit or associate members may hold office, but only benefit members may vote in the corporate and insurance affairs of the society. All branches annually hold an election for the purpose of electing three members to the board of directors. Benefit members vote on a slate of candidates nominated by the board and by the various branches.

Growth of Membership

Year	Benefit Members	Associate Members	Total
1995	1,655,368	54,315	1,709,683
1996	1,660,307	49,168	1,709,475
1997	1,663,381	55,307	1,718,688
1998	1,660,398	77,601	1,737,999
1999	1,668,118	94,364	1,762,482

The decrease in benefit members in 1998 resulted from the discontinuation of double counting some members who have multiple certificates issued by the society.

Board of Directors

The board of directors consists of seventeen members. It consists of twelve elected directors, and five appointed directors. The society's benefit members elect the elected directors to serve staggered terms of four years. Under the bylaws, the board may appoint up to four benefit members and two principal officers of AAL to serve as appointed directors for a one-year term. The board elects a chairman and vice-chairman from among its members for up to a one-year term. The vice-chairman currently receives $54,000 annually as compensation, while all other directors receive $48,000.

Currently the board of directors consists of the following persons:

Name and Residence	Principal Occupation	Term Expires
Raymond G. Avischious Colorado Springs, CO	Retired - Consultant Shurfine Corporation	2004
Richard E. Beumer Town & Country, MO	Vice Chairman Jocobs Engineering Group Inc.	2003
Kenneth Daly Malvern, PA	Certified Public Accountant, Partner KPMG, LLP	2001
Elizabeth A. Duda Oviedo, FL	Homemaker	2002
Edward A. Engel Chicago, IL	President Edward A. Engel & Associates	2001
John O. Gilbert Appleton, WI	Chairman, President and Chief Executive Officer Aid Association for Lutherans	2001
Karen P. Goebel Madison, WI	Professor University of Wisconsin - Madison	2001
Gary J. Greenfield Wauwatosa, WI	President Wisconsin Lutheran College	2002
Robert H. Hoffman Waseca, MN	Vice President Taylor Corporation	2003
Robert E. Long Pewaukee, WI	Senior Vice President Park Bank	2002
Robert B. Peregrine Oconomowoc, WI	President Peregrine & Roth, S.C.	2004

Paul D. Schrage Chicago, IL	Retired McDonald's Corp.	2001
James H. Scott Berwyn, PA	Principal Miller Anderson and Sherrerd, LLP	2001
Kathi P. Seifert Appleton, WI	Executive Vice President Kimberly-Clark Corp	2004
Roger G. Wheeler Bloomington, MN	Retired, currently Owner/President Wheel-Air Inc. and Wheel-Air Charter, Inc.	2003
Marlene Wilson Boulder, CO	President Volunteer Management Association	2001
Thomas R. Zehnder Williamsburg, VA	Pastor King of Glory Lutheran Church	2001

Officers of the Society

The officers appointed by the board of directors and serving at the time of this examination are as follows:

Name	Office	Compensation
John O. Gilbert	President and Chief Executive Officer	$1,046,470
James H. Krueger	General Agent, and Director of Agencies	639,901
Walter S. Rugland	Executive VP and COO	535,441
Woodrow E. Eno	Sr. VP, Secretary, General Counsel	488,741
James H. Abitz,	Sr. VP and Chief Investment Officer	454,639
Steven A. Weber	Sr. VP – People, Marketing & Technology Solutions	435,323
Russell A. Evenson	Sr. VP – Benefit and Product Solutions	381,616
Frederick A. Ohlde	Sr. VP – Fraternal Operations	300,494
Carl J. Rudolph	Sr. VP, Chief Financial Officer, Controller & Treasurer	250,080
Jon M. Stellmacher	Sr. VP – Member Services	222,235
Robert A. Lyle	Vice President & Corporate Actuary	212,106

Committees of the Board

The society's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Executive Committee
Kathi Seifert, Chair
Gary Greenfield, Vice Chair
Paul Schrage
Thomas Zehnder

Finance and Audit Committee
Kenneth Daly, Chair
Robert Peregrine, Vice Chair
Elizabeth Duda
James Scott

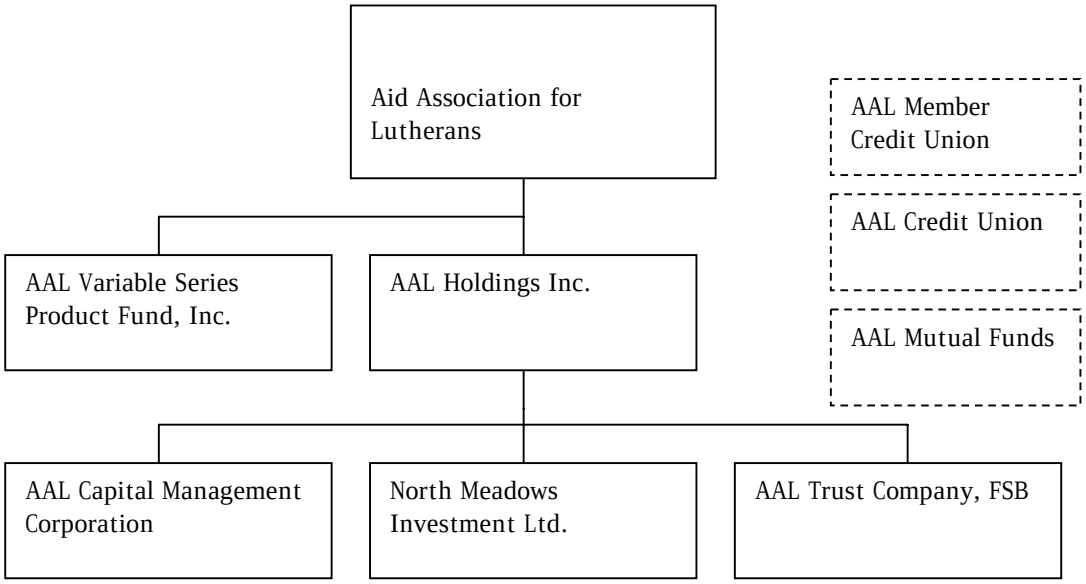
Governance Committee
Roger Wheeler, Chair
Richard Beumer, Vice Chair
John Gilbert
Robert Long

Fraternal Committee
Marlene Wilson, Chair
Raymond Avischious, Vice Chair
Edward Engel
Robert Hoffman

IV. AFFILIATED COMPANIES

Aid Association for Lutherans is the ultimate parent of a holding company system. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the subsidiaries and affiliates follows the organizational chart.

Organizational Chart
As of December 31, 1999



AAL Holdings, Inc.

The society owns 100% of the common stock of AAL Holdings, Inc. (Holdings), a downstream holding company. Holdings owns 100% of the common stock of AAL Capital Management Corporation, AAL Trust Company, FSB and North Meadows Investment, Ltd. The society reports the common stock of Holdings using the equity method.

As of December 31, 1999, the audited consolidated financial statements of Holdings reported assets of $42,169,728, liabilities of $13,121,491, and shareholder's equity of $29,048,237. Operations for 1999 produced a net profit of $1,214,193.

AAL Capital Management Corporation

This company, a wholly owned subsidiary of Holdings, was formed in March 1991 with the merging of AAL Advisors, Inc., and AAL Distributors, Inc. These two companies were organized as for-profit stock corporations under Delaware statutes in 1986. AAL Capital Management serves as a broker/dealer in securities and as an investment advisor, which supports the offering of mutual fund investments to AAL members. As of December 31, 1999, the company's audited financial statement reported assets of $25,877,863, liabilities of $12,354,775, and shareholder's equity of $13,523,088. Operations for 1999 produced a net profit of $1,539,092.

AAL Trust Company, FSB

This company was organized as a for-profit trust and investment management company on November 1,1998, under federal law and is a wholly owned subsidiary of Holdings. Effective, April 1999, the company became a Registered Investment Adviser under the Investment Advisers Act of 1940. As of December 31, 1999, the company's audited financial statement reported assets of $2,491,040, liabilities of $686,010, and shareholder's equity of $1,805,030. Operations for 1999 produced a loss of $662,435.

North Meadows Investment, Ltd.

This company was organized as a for-profit stock corporation under Wisconsin statutes and began operations during 1985. The company, a wholly owned subsidiary of Holdings, was established to invest in various real estate projects. As of December 31, 1999, the company's unaudited financial statement reported assets of $13,013,386, liabilities of $567,335, and shareholder's equity of $12,446,051. Operations for 1999 produced a net profit of $351,775.

AAL Variable Product Series Fund, Inc.

This company was organized as an open-ended diversified management company, in 1994 and was incorporated under the laws of Maryland and registered under the Investment Company Act of 1940, as amended. The fund is beneficially owned by members in units purchased. The company is a "series" fund consisting of seven separate investment portfolios (known as Small Company Stock, International Stock, Large Company Stock, Balanced High

Yield Bond, Bond, and Money Market Portfolios). Shares of the fund are currently sold only to the AAL Variable Annuity Account I, the AAL Variable Annuity Account II, and the AAL Variable Life Account I, to fund benefits under certificates of membership related to the variable insurance contracts issued by AAL and as investment options in the AAL Employee Savings Plan in the International Stock, Large Company Stock, and High Yield Bond Portfolios. Assets are owned by Unit Investment Trusts, AAL and AAL Employee Savings Plan.

AAL Mutual Funds

The society established several mutual funds in 1987 to meet the changing needs of its members. As with all mutual funds, the funds sponsored by AAL are owned by the individual investors. In 1994 and 1995, the investment management of the funds was brought into the AAL organization from an outside firm.

Credit Unions

The society established the AAL Member Credit Union for its members and the AAL Credit Union for employes and fieldworkers to provide additional financial services. The credit unions are sponsored by AAL and owned by the individual depositors.

Affiliated Agreements

The society leases office space and furniture to the AAL Member Credit Union and other affiliates under the terms of signed agreements. Each month the society bills the subsidiaries for rent, telecommunication services, payroll processing, employe benefits, supplies, and other items.

AAL Capital Management Corporation receives from The AAL Mutual Funds concessions from the sales of fund shares under a distribution agreement and additional fees for investment management and administrative services.

AAL Variable Product Series Fund, Inc., had an investment advisory agreement with AAL relating to the management of the portfolios and paid AAL a fee for these services. In addition, AAL Variable Product Series Fund, Inc., entered into a sub-advisor agreement with AAL Capital Management Corporation for the High Yield Bond Portfolio. AAL Variable Product Series Fund, Inc., entered into a sub-advisory agreement with Oechsle International Advisors, L.L.C. for

the International Stock Portfolio and the fees were paid by AAL. Effective January 1, 2000, the AAL Variable Product Series Fund, Inc., board of directors approved the transfer of the investment advisory responsibilities from AAL to AAL Capital Management Corporation for the AAL Variable Product Series Fund, Inc. AAL Variable Product Series Fund, Inc. will pay fees to AAL Capital Management Corporation for these services. The previous agreement was terminated effective December 31, 1999. In addition, AAL Capital Management Corporation pays a sub-advisor fee to Oechsle International Advisors, L.L.C. per the new agreement for the International Stock Portfolio.

AAL Capital Management Corporation has a distribution agreement with AAL. The agreement calls for concessions from the sales of variable products. AAL Capital Management Corporation is reimbursed for commissions paid to the field on behalf of these variable products by AAL.

V. REINSURANCE

The society's reinsurance portfolio and strategy are described below. A list of the companies that have a significant amount of reinsurance in force at the time of the examination follows.

The society's major reinsurance treaties in force at the time of the examination are summarized below. The contracts contained proper insolvency provisions.

Ceding Contracts

1. Type: Automatic and Facultative Yearly Renewable Term

   Reinsurer: Swiss Re Life and Health America, Inc. (formally Swiss Re America) (formerly North American Re)

   Lines covered: Individual Life and Waiver of Premium Disability

   Retention: $1,000,000 per risk

   Coverage: Amount of risk in excess of AAL's retention not to exceed the following limits:

Risk Class	Limit
Standard	$2,500,000
Table A - Table B	2,000,000
Table C - Table D	1,500,000
Table E - Table P	1,000,000

   Amounts above automatic coverage may be ceded upon a facultative basis

   Premium: Annual premium rate is the greater of:
   a) the gross premium rates per Exhibit B of the reinsurance contract, or
   b) the gross premium rates actually charged the insured, less a percentage reduction based upon plan and policy year

   Effective date: March 15, 1988

   Termination: For new business, by either party giving the other party 90 days' written notice. This agreement remains in effect for those policies already reinsured under this contract prior to termination

2. Type: Automatic and Facultative Yearly Renewable Term

   Reinsurer: Lincoln National Life Insurance Company

   Lines covered: Individual Life and Waiver of Premium Disability

   Retention: $1,000,000 per risk

Coverage: Maximum amounts which may be ceded automatically:

Life

Ages	Standard-Table P	Over Table P
0-70	$2,000,000	None
Over 70	None	None

Waiver of Premium Disability

Ages	Standard-Table F	Over Table F
0-44	$2,000,000	None
45-65	1,000,000	None
Over 65	None	None

Amounts not covered under the automatic cession may be submitted to the reinsurer on a facultative basis for approval

Premium: Premium shall be the sum of:

1. The premium rate from Schedule D applied to the amount of risk, plus
2. Policy fee of $15 for first year policies and $10 for renewals, plus
3. Any flat extra premium charged the insured on the face amount initially reinsured less an allowance of 75% of any first year flat extra premium and 10% of any renewal flat extra premium

Effective date: October 1, 1982

Termination: For new business, this contract was terminated on March 15, 1988. This agreement remains in effect for those policies already reinsured under this contract prior to termination

3. Type: Automatic and Facultative Coinsurance

Reinsurer: Lincoln National Life Insurance Company

Lines covered: Individual Life and Waiver of Premium Disability

Retention: $1,000,000 per risk

Coverage: Maximum amounts which may be ceded automatically:

Life

Ages	Standard-Table P	Over Table P
0-70	$2,000,000	None
Over 70	None	None

Waiver of Premium Disability

Ages	Standard-Table F	Over Table F
0-44	$2,000,000	None
45-65	1,000,000	None
Over 65	None	None

Amounts not covered under the automatic cession may be submitted to the reinsurer under facultative basis for approval

Premium: Gross premiums (less policy fee) of amount reinsured less allowances

Experience refunds: Based upon a formula, not to exceed $350,000

Effective date: December 1, 1982

Termination: For new business, this contract was terminated on March 15, 1988. This agreement remains in effect for those policies already reinsured under this contract prior to termination

4. Type: Coinsurance

Reinsurer: Indianapolis Life Insurance Company

Lines covered: Survivor Life Insurance (2nd to die)

Retention: None, all liability is ceded

Premium: 100% of premiums received

Return commission: Per Exhibit B, ranges from 100% on new policies to 7% on policies issued 11 or more years ago

Effective date: January 1, 1994

Termination: For new business, by either party giving the other 30 days' notice

5. Type: Coinsurance

Reinsurer: The Lincoln National Life Insurance Company

Lines Covered: Term policies listed with face amounts greater than $100,000
New York business shall not be reinsured.
Issue ages are 0-80.

Retention: 50% of each Policy face amount not to exceed $1,000,000.

Coverage: 50% of each Policy face amount up to $2,000,000. 100% of face amount over $2,000,000.

Maximum Cession:

Automatic Limits

Ages	Standard	Tables A-D	Tables E-P
0-80	$2,500,000	$1,500,000	$1,000,000

Participation Limits

Ages	Standard Table P
0-80	$5,000,000

Premium: Appropriate rate based upon the Premium Rate Schedule times the monthly reinsured benefit ceded. Expense allowance on policies greater than $100,000

Effective Date: April 1, 2000

Termination: 3 years after April 1, 2000, by either party with 90 days' notice.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the society as reported in the December 31, 1999, annual statement to the Commissioner of Insurance. Also included in this section are schedules which reflect the growth of the society, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted in the section of this report captioned "Reconciliation of Members' Surplus per Examination."

Aid Association for Lutherans
Assets
As of December 31, 1999

	Ledger Assets	Nonledger Assets	Nonadmitted Assets	Admitted Assets
Bonds	$13,593,127,925	$	$	$13,593,127,925
Stocks:				
Preferred stocks	19,163,048			19,163,048
Common stocks	574,110,274	284,822,192		858,932,466
Mortgage loans on real estate:				
First lien	3,254,903,134			3,254,903,134
Real estate:				
Occupied by the society	68,511,036			68,511,036
Acquired in satisfaction of debt	22,243,956		1,826,326	20,417,630
Investment real estate	33,056,818			33,056,818
Certificate loans and liens	491,360,937			491,360,937
Cash	(37,193,578)			(37,193,578)
Short-term investments	254,339,272			254,339,272
Other invested assets	3,990,618			3,990,618
Receivable for securities	2,555,142			2,555,142
Write-ins for invested assets:				
Other loans, options	5,068,998	437,757	4,544,018	962,736
Reinsurance ceded:				
Amounts recoverable from reinsurers	1,957,500			1,957,500
Commissions and expense allowances due	120,886			120,886
Experience rating and other refunds due	22,386			22,386
Electronic data processing equipment	6,267,815	126,234		6,394,049
Life premiums and annuity considerations deferred and uncollected		813,751		813,751
Accident and health premiums due and unpaid		860,615		860,615
Investment income due and accrued		215,278,227	239,697	215,038,530
Receivable from subsidiaries and affiliates	8,473,233			8,473,233
Other assets:				
Fieldworkers' balances	4,544,965		4,544,965	
Furniture and equipment	12,309,418	305,073	12,614,491	
Cash advanced to or in hands of officers or fieldworkers	369,071		369,071	
Write-ins for noninvested assets:				
Amount due from property mgr.	468,235			468,235
EDP software	7,347,478	186,320	7,533,798	
Miscellaneous	751,715		751,715	
Audiovisual equipment	256,632		256,632	
Prepaid expenses	76,734		76,734	
Total Assets excluding Separate Accounts business	18,328,203,648	502,830,169	32,757,447	18,798,276,369
From Separate Accounts Statement		2,002,134,569		2,002,134,569
Total Assets	$18,328,203,648	$2,504,964,738	$32,757,447	$20,800,410,938

Aid Association for Lutherans
Liabilities, Surplus, and Other Funds
As of December 31, 1999

Aggregate reserve for life certificates and contracts	$15,118,468,948
Aggregate reserve for accident and health certificates	457,812,634
Supplementary contracts without life contingencies	676,291,925
Certificate and contract claims:	
Life	68,212,994
Accident and health	15,636,954
Refund accumulations	44,716,818
Refunds due and unpaid	168,494
Provision for refunds payable in following calendar year:	
Apportioned for payment to December 31, 2000	116,840,190
Premiums and annuity considerations received in advance	16,280,532
Liability for premium and other deposit funds	149,642
Certificate and contract liabilities not included elsewhere:	
Interest maintenance reserve	116,402,344
Commissions to fieldworkers due or accrued	12,766,954
General expenses due or accrued	28,301,534
Transfers to separate accounts due or accrued (net)	(91,829,970)
Taxes, licenses, and fees due or accrued	1,311,285
Unearned investment income	312,563
Amounts withheld or retained by society as agent or trustee	2,707,335
Remittances and items not allocated	4,695,254
Liability for benefits for employes and fieldworkers if not included above	28,185,476
Miscellaneous liabilities:	
Asset valuation reserve	380,870,517
Payable for securities	3,814,646
Write-ins for liabilities:	
Post retirement benefit liability	30,052,458
Community grant	7,880,000
Accrued interest on unpaid certificates	788,494
Unclaimed checks	672,961
Provision for obligations	356,386
EDP payable	312,554
Total Liabilities excluding Separate Accounts business	17,042,179,922
From Separate Accounts Statement	2,002,134,569
Total Liabilities	19,044,314,491
Unassigned funds (surplus)	1,756,096,448
Total Liabilities, Surplus, and Other Funds	$20,800,410,939

Aid Association for Lutherans
Summary of Operations
For the Year 1999

Premiums and annuity considerations	$1,583,734,174
Considerations for supplementary contracts with life contingencies	66,559,962
Considerations for supplementary contracts without life contingencies and refund accumulations	197,666,932
Net investment income	1,255,754,199
Amortization of interest maintenance reserve	34,168,445
Commissions and expense allowances on reinsurance ceded	2,627,693
Reserve adjustments on reinsurance ceded	(17,864)
Miscellaneous income:	
Income from fees associated with investment management, administration and contract guarantees from separate accounts	22,813,892
Write-ins for miscellaneous income:	
Miscellaneous income	6,332,466
Total income items	3,169,639,897
Death benefits	237,123,208
Matured endowments	2,951,692
Annuity and old age benefits	739,455,235
Disability, accident, and health benefits including premiums waived	78,358,770
Surrender benefits	157,888,698
Interest on certificate or contract funds	4,245,944
Payments on supplementary contracts with life contingencies	73,232,596
Payments on supplementary contracts without life contingencies and of refund accumulations	194,910,309
Increase in aggregate reserve for life and accident and health certificates and contracts	582,694,148
Increase in reserve for supplementary contracts without life contingencies and for refund accumulations	40,367,458
Subtotal	2,111,228,059
Commissions on premiums, annuity considerations, and deposit-type funds	108,985,250
Commissions and expense allowances on reinsurance assumed	
General insurance expenses and fraternal expenses	279,264,641
Insurance taxes, licenses, and fees	13,793,779
Increase in loading on and cost of collection in excess of loading on deferred and uncollected premiums	(45,829)
Net transfers to or (from) separate accounts	361,803,545
Write-in for deductions:	
Community grant	7,880,000
Employee benefits	2,460,064
Miscellaneous	43,167
Transition reserve	(263,482)
Total deductions	2,885,149,194
Net gain from operations before refunds to members	284,490,703
Refunds to members	116,605,454
Net gain from operations after refunds to members and before realized capital gains or (losses)	167,885,249
Net realized capital gains or losses	87,659,743
Net Income	$ 255,544,992

Aid Association for Lutherans
Cash Flow
As of December 31, 1999

Premiums and annuity considerations	$1,585,765,965		
Considerations for supplementary contracts with life contingencies	66,559,962		
Considerations for supplementary contracts without life contingencies and refund accumulations	197,666,932		
Net investment income	1,249,568,649		
Commissions and expense allowances on reinsurance ceded	2,555,862		
Fees associated with investment management, admin. and contract guarantees from Separate Accounts	22,813,892		
Write-ins for miscellaneous income:			
Miscellaneous income	6,332,466		
Total		$3,131,263,727	
Death benefits	245,759,840		
Matured endowments	3,050,111		
Annuity and old age benefits	740,139,290		
Disability, accident, and health benefits	80,095,930		
Surrender benefits	157,896,910		
Interest on certificate or contract funds	4,172,035		
Payments on supplementary contracts with life contingencies	74,220,413		
Payments on supplementary contracts without life contingencies and refund accumulations	195,669,293		
Subtotal	1,501,003,821		
Commissions on premiums, annuity considerations, and deposit-type funds	107,399,121		
General insurance expenses and fraternal expenses	279,523,415		
Insurance taxes, licenses, and fees	13,726,087		
Net transfers to or (from) Separate Accounts	383,142,119		
Refunds to members paid	113,633,718		
Total deductions		2,398,428,280	
Net cash from operations			$732,835,447
Proceeds from investments sold, matured, or repaid:			
Bonds	3,150,428,176		
Stocks	635,860,422		
Mortgage loans	261,887,289		
Real estate	9,361,697		
Net gains or (losses) on cash and short-term investments	(1,833)		
Total investment proceeds		4,057,535,752	
Cost of investments acquired (long-term only):			
Bonds	3,921,212,834		
Stocks	579,747,852		
Mortgage loans	248,939,904		
Real estate	4,478,243		
Miscellaneous applications	122,545		
Total investments acquired		4,754,501,378	

Net increase (or decrease) in certificate loans and liens		(5,144,551)	
Net cash from investments			(691,821,075)
Cash applied for financing and miscellaneous uses:			
Other applications	38,796,581		
Total		38,796,581	
Net cash from financing and miscellaneous sources			(38,796,581)
Net change in cash and short-term investments			2,217,791
Reconciliation			
Cash and short-term investments, December 31, 1998			214,927,903
Cash and short-term investments, December 31, 1999			$217,145,694

Aid Association for Lutherans
Compulsory and Security Surplus Calculation
December 31, 1999

Assets		$20,800,410,939	
Less liabilities		19,044,314,491	
Adjusted surplus			$1,756,096,448
Annual premium:			
Individual life and health	$662,179,183		
Factor	15%		
Total		$ 99,326,877	
Greater of 7.5% of consideration or 2% of reserves for annuities and deposit administration funds		150,171,197	
Compulsory surplus (subject to a $2,000,000 minimum)			249,498,074
Compulsory surplus excess or (deficit)			$1,506,598,374
Adjusted surplus			$1,756,096,448
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million with a minimum of 110%)			274,447,881
Security surplus excess or (deficit)			$1,481,648,567

Aid Association for Lutherans
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 1999

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	1995	1996	1997	1998	1999
Surplus, beginning of year	$877,938,678	$942,683,171	$1,093,135,073	$1,380,480,113	$1,517,975,255
Net income	114,466,077	129,701,584	209,757,372	133,681,674	255,544,992
Change in net unrealized capital gains or (losses)	56,950,650	77,961,574	81,359,822	83,272,416	(6,783,172)
Change in nonadmitted assets and related Items	(3,182,881)	(3,581,516)	2,117,142	2,042,028	4,664,710
Change in liability for reinsurance in Unauthorized companies					
Change in reserve on account of change in valuation basis					
Change in asset valuation reserve	(78,489,353)	(53,629,740)	(5,889,296)	(59,317,532)	(30,482,735)
Write-ins for gains and (losses) in surplus:					
Decrease(increase) in certificate reserves	(25,000,000)			(22,183,443)	15,177,398
Surplus, end of year	$942,683,171	$1,093,135,073	$1,380,480,113	$1,517,975,255	$1,756,096,448

Growth of Aid Association for Lutherans

Year	Admitted Assets	Liabilities	Members' Surplus
1995	$15,393,457,242	$14,450,774,074	$ 942,683,168
1996	16,357,945,639	15,264,810,566	1,093,135,073
1997	17,149,818,000	15,769,337,887	1,380,480,113
1998	18,011,264,794	16,493,289,538	1,517,975,256
1999	18,798,276,370	17,042,179,922	1,756,096,448

Life Insurance In Force (in thousands)

Year	Gross Direct	Ceded	Net
1995	$75,593,366	$304,064	$75,289,302
1996	78,814,992	433,880	78,381,112
1997	81,992,483	552,519	81,439,964
1998	85,091,991	688,588	84,403,403
1999	88,012,238	825,845	87,186,393

Accident and Health

Year	Net Premiums Earned	Net Losses Incurred	Commissions Incurred	Other Expenses Incurred	Combined Loss and Expense Ratio
1995	$122,747,149	$ 97,975,932	$11,235,757	$37,700,409	119.8%
1996	123,608,970	103,315,182	11,318,271	38,452,071	123.8
1997	133,583,916	105,037,411	12,695,610	35,866,243	115.0
1998	143,733,483	129,910,138	12,949,414	34,585,127	123.5
1999	155,161,596	151,615,506	14,236,672	33,835,449	128.7

Accident and Health premium growth can be attributed to its long term care product as growth in medical supplement and disability income products were minimal.

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were five specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the society are as follows:

1. Bonds and Stocks—It is recommended that the society amend its safekeeping agreement to include provisions requiring:

   a. That the trust company as custodian is obligated to indemnify the society for any loss of securities of the society in the trust company's custody occasioned by the negligence or dishonesty of the trust company's officers or employes, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction.

   b. That in the event that there is a loss of the securities for which the trust company is obligated to indemnify the society, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

   Action—Compliance.

2. Bonds and Stocks—It is recommended that the society properly report loaned securities and securities which are not under its exclusive control in future annual statements, by denoting them with the appropriate letters or some other means which readily identifies them.

   Action—Compliance.

3. Other Invested Assets—It is recommended that in future annual statements, the society report unsecured loans as nonadmitted assets.

   Action—Compliance.

4. Aggregate Reserve for Life Certificates and Contracts—It is recommended that the society appropriately reserve for surrender values in excess of reserves in future annual statements.

   Action—Compliance.

5. Aggregate Reserve for Life Certificates and Contracts—It is recommended that the society appropriately reserve for automatic payment options on annuities in future annual statements.

   Action—Compliance.

Summary of Current Examination Results

Securities Lending Program

The society has been participating in a securities lending program since 1994. The society has entered into an agreement with a bank to administer its securities lending program and to act as custodian for the collateral received. This agreement did not contain satisfactory safeguards and controls as specified in the NAIC Examiners Handbook. It is recommended that the society amend its agency agreement to include provisions requiring:

> That the trust company as custodian is obligated to indemnify the society for any loss of securities of the society in the trust company's custody occasioned by the negligence or dishonesty of the trust company's officers or employes, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction; and
>
> That in the event that there is a loss of the securities for which the trust company is obligated to indemnify the society, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

.

In addition, the agreement does not state that if the collateral received is denominated in a different currency than the securities loaned, the minimum collateral on these securities loaned is 105% of the market value of the loaned securities as noted in the Purpose and Procedures Manual of the NAIC Securities Valuation Office. It is recommended that the society either include provisions requiring additional collateral requirements relating to collateral denominated in a different currency or include provisions that specify collateral must be denominated in the same currency as securities loaned.

As stated in the Purpose and Procedures Manual of the NAIC Securities Valuation Office, a daily "mark to market" or valuation procedure must be in place to ensure that the market value of the collateral never goes below 100% of the market value of securities loaned and that call for additional collateral to maintain the 102% minimum which should be made on a timely basis. The examiners noted instances where, for several consecutive business days, the market value of the collateral was less than 102% of the market value of loaned securities and a few of these instances when the collateral was less than 100% of the market value of loaned securities. The examination noted that it was the practice of the bank administering the program to negotiate

with the counter party concerning the valuation of bonds, and that bond values were subject to differing interpretations of value depending on the pricing service used. This was not the case for stocks, for which the ending day's market price was consistently used. It is recommended that the society revise its agency agreement to specify the bond valuation service to be used for the daily valuation of loaned securities and that the society take steps necessary to ensure that additional collateral is promptly received when necessary to maintain 102% of securities loaned.

Mortgage Loans

The balance for this account as of December 31, 1999, included nine mortgage loans in which its terms had been restructured due to actual or anticipated delinquency. In addition, either due to its delinquency or as a result of the restructuring of its terms, the current appraised value of the collateral was no longer sufficient to secure the entire unpaid principal balance. The society believes that they will be able to collect the entire unpaid principal balance and therefore reported the entire balance as an admitted asset.

Current guidance is unclear on this issue, but implies that any unsecured portion should be nonadmitted. Under codification, which becomes effect January 1, 2001, the subject loans would be considered temporarily impaired. The reporting entity will be instructed to measure the impairment based on the fair value (as determined by acceptable appraisal methodologies) of the collateral less estimated costs to obtain or sell. For reporting entities that maintain asset valuation reserve (AVR), the unrealized gain or loss on impairments shall be included in the calculation of the AVR. Subsequent to the initial measurement of impairment, if there is a significant change (increase or decrease) in the net value of the collateral, the reporting entity shall adjust the valuation reserve; however, the net carrying value of the loan shall at no time exceed the recorded investment in the loan.

No adjustment to surplus is proposed due to lack of materiality. However, it is recommended that in future annual statements, the society either create a valuation allowance (a contra-asset) for the portion of the unpaid principal balance which is not properly secured by collateral if it is considered to be a temporary difference, or write down the mortgage loan

(recognizing a realized loss and establishing a new cost basis) if it is considered to be an other than temporary difference.

VIII. CONCLUSION

AAL's surplus increased during each of the five years under examination. As of December 31, 1999, the society reported total admitted assets in excess of $20 billion, and surplus of $1,756,096,448. Operations in 1999 produced a net income of $255,544,992.

Total earned premiums have increased steadily during each of the five years under examination. Annuity products remain the society's largest line of business and vary depending on the movement of market interest rates. Accident and health premiums have increased during the period, but the majority of the increase relates to long term care products. The society had 1,668,118 benefit (voting) members at the end of 1999, as membership continued to grow at a modest rate during the period under examination.

The financial examination resulted in four recommendations. Three of the four recommendations related to the securities lending program that was established in 1994. No adjustments were made to surplus as a result of the examination.

VIIII. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 28 - Security Lending Program—. It is recommended that the society amend its agency agreement to include provisions requiring:

   a. That the trust company as custodian is obligated to indemnify the society for any loss of securities of the society in the trust company's custody occasioned by the negligence or dishonesty of the trust company's officers or employes, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction.

   b. That in the event that there is a loss of the securities for which the trust company is obligated to indemnify the society, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced.

2. Page 28 - Security Lending Program—It is recommended that the society either include provisions requiring additional collateral requirements relating to collateral denominated in a different currency or include provisions that specify collateral must be denominated in the same currency as securities loaned.

3. Page 29 - Security Lending Program—It is recommended that the society revise its agency agreement to specify the bond valuation service to be used for the daily valuation of loaned securities and that the society take steps necessary to ensure that additional collateral is promptly received when necessary to maintain 102% of securities loaned.

4. Page 29 - Mortgage Loans—It is recommended that in future annual statements, the society either create a valuation allowance (a contra-asset) for the portion of the unpaid principal balance which is not properly secured by collateral if it is considered to be a temporary difference, or write down the mortgage loan (recognizing a realized loss and establishing a new cost basis) if it is considered to be an other than temporary difference.

IX. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employes of the society is acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, state of Wisconsin, participated in the examination:

Name	Title
Cruz Flores	Data Processing Audit Specialist
Jerry C. DeArmond	Policy and Claim Reserve Specialist
David Grinnell	Insurance Financial Examiner
Christine Shan	Insurance Financial Examiner

Respectfully submitted,

Tim Vande Hey
Examiner-in-Charge
Insurance Financial Examiner