

REPORT OF
FINANCIAL EXAMINATION
THE CATHOLIC KNIGHTS OF AMERICA



AS OF
DECEMBER 31, 2003

STATE OF MISSOURI
DEPARTMENT OF INSURANCE
JEFFERSON CITY, MISSOURI

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May 5, 2004
St. Louis, Missouri

Honorable Alfred W. Gross, Commissioner
State Corporation Commission
Bureau of Insurance
Commonwealth of Virginia
Chairman, (EX 4) Financial Condition Subcommittee, NAIC

Honorable Sally McCarty, Commissioner
Indiana Department of Insurance
Secretary, Midwestern Zone, NAIC

Honorable Scott B. Lakin, Director
Missouri Department of Insurance
301 West High Street, Room 530
Jefferson City, Missouri 65101

Lady and Gentlemen:

In accordance with your financial examination warrant, a full scope association financial examination has been made of the records, affairs and financial condition of

The Catholic Knights of America

hereinafter referred to as such or as "CKA" or as the "Society." The Society's home office is located at 3525 Hampton Avenue, St. Louis, Missouri 63139, telephone number (314) 351-1029.

This examination began on March 8, 2004 and concluded on May 5, 2004.

SCOPE OF EXAMINATION

Period Covered

The last full scope association financial examination of the Society was made as of December 31, 1999, by examiners from the state of Missouri representing the Midwestern Zone

of the National Association of Insurance Commissioners (NAIC) with no other zones participating.

The current full scope association financial examination covers the period from January 1, 2000, through December 31, 2003, and was conducted by examiners from the state of Missouri representing the Midwestern Zone of the NAIC with no other zones participating.

This examination also included material transactions and/or events occurring subsequent to December 31, 2003.

Procedures

This examination was conducted using the guidelines set forth in the Financial Condition Examiners Handbook of the National Association of Insurance Commissioners (NAIC), except where practices, procedures and applicable regulations of the Missouri Department of Insurance and statutes of the state of Missouri prevailed.

The Missouri Department of Insurance engaged an independent actuary, Timothy F. Harris, FCAS, MAAA, with Milliman USA, to perform a review of the Society's reserve calculations and reserving methodologies.

Comments - Previous Examination

Listed below are the comments and recommendations taken from the prior Report of Financial Examination made as of December 31, 1999. The responses or actions taken by the Society are also described below.

1. Comment: Securities Valuation Office Filings

It was recommended that the Society take the necessary steps to ensure that all investments owned that do not meet the requirements of "Provisionally Exempt Securities" be properly registered with the Securities Valuation Office.

Society Response:

“There was one item from the previous examination that was not completely corrected, that being several investments on which SVO ratings have not been obtained. During this time, the Society’s President serviced as the Chairman of the NFCA’s Investment and SVO Committee. Therefore, he was aware of the upcoming changes allowing for the substitution of other rating agencies, a change that would alleviate the Society from the costs of these SVO filings. Anticipating a 01/01/00 effective date, it seemed imprudent to proceed with that expense.”

Current Findings:

Effective January 1, 2004, the Securities Valuation Office of the NAIC has again changed its filing requirements. Although CKA had \$742,184 of bonds that were not properly filed with the SVO at December 31, 2003, 82% of these bonds will not require filing under rules that became effective January 1, 2004. It is recommended that the Society take the necessary steps to ensure that all investments owned that do not meet the new requirements of "Filing Exempt" be properly registered with the SVO.

2. Comment: Real Estate Acquisition Approval

The Society was directed to submit information regarding the 1998 purchase of real estate to the Missouri Department of Insurance (MDI) for approval pursuant to Section 375.330 RSMo (Purchase and ownership of real estate).

Society Response:

“The Society regrets having not submitted a request for the approval of the purchase of our property in West Virginia, prior to making that purchase. At that time, we were unaware of the regulation and have since then submitted a formal request for that approval.”

Current Findings:

CKA submitted information regarding the purchase of the West Virginia property to MDI in August 2000. On September 6, 2000, MDI issued a letter stating that the Department had no intention of disapproving the transaction.

3. *Comment: Advances to CKA Center*

It was recommended that the Board of Trustees review the financial projections of The CKA Center and specify a maximum dollar amount that will be advanced for start-up costs for the assisted living center.

Society Response:

“The Board of Trustees will review the financial projections of The C.K. of A. Center, and at which time they will also review the various options available to them through which they can protect the assets of the membership.”

Current Findings:

The CKA center continues to be a major contribution to the decline of policyholders’ surplus, which has decreased by approximately 56% since the prior examination. See the “Affiliated Companies” section of this report for further findings in this area.

4. *Comment: Contingent Liabilities*

It was recommended that the Society properly disclose all contingent liabilities in the Notes to Financial Statements in future Annual Statements.

Society Response:

“The Society apologizes for failing to note its Contingent Liabilities in the last statement, and will make sure this is corrected in future statements.”

Current Findings:

The Society continued to fail to disclose its commitment to guarantee loans totaling up to \$740,000 in its financial statements from 2000-2003. In 2004, CKA amended its 2003 Annual Statement to properly disclose this information.

5. *Comment: Catholic Credit Union*

It was recommended that the Society form an agreement detailing any resources that will be shared and specify that no funds will be commingled before allowing a credit union to share space in its home office.

Society Response:

“Upon approval of the Commission of Credit Unions in the State of Missouri, we will finalize our plans to operate this Credit Union from The Catholic Knights of America’s Home Office.” “Please note that the Society is aware that funds must be maintained separately and may not be commingled.”

Current Findings:

In April of 2004, CKA entered an agreement with the Common Cents Credit Union stating that no funds would be commingled between the parties.

HISTORY

General

The Catholic Knights of America was founded in April 1877, at the suggestion of Most Reverend P.A. Feehan, Bishop of Nashville, Tennessee. The Society began as an assessment type insurance society under a special charter granted by the assembly of the state of Kentucky.

The Society was originally known as "The Order of United Catholics." The name was changed to the "Catholic Knights of Honor," and was changed again to its present name of "The Catholic Knights of America."

The Commonwealth of Kentucky issued a formal charter in 1880, making the Society one of the founders of the chartered fraternal benefit associations in the United States. On April 13, 1916, the Supreme Officers applied to the state of Missouri for Articles of Incorporation, which were granted and filed April 21, 1916. Since that time, the Society has been operating under the laws of the state of Missouri. The Society is currently authorized to transact business as a fraternal benefit society under the provisions of Chapter 378 RSMo (Fraternal Benefit Societies).

Capital Stock

The Society is a not-for-profit organization owned by its members; consequently it has no capital stock.

Dividends

The Society has not declared or paid any dividends, as it has no stockholders.

Management

The law-making power of the Society is vested in the National Council, which enacts laws for the government of the Society. The National Council is comprised of delegates elected by the State Councils who elect a National Board of Trustees. The National Council meets every three years. As of December 31, 2003, the members of the National Board of Trustees were as follows:

<u>Name and Address</u>	<u>Principal Occupation</u>
Delia A. Arnold River Ridge, LA	Paralegal - Legal Secretary Ochner Clinic
Thomas E. Diebold St. Louis, MO	Department Supervisor St. Louis Metropolitan Sewer District
Robert N. Dippold Maria Stein, OH	Mechanical Engineer Bing Assembly System
Sandra E. Jacobs St. Louis, MO	DRG Coordinator Lutheran Medical Center
John F. Kenawell St. Louis, MO	National President The Catholic Knights of America
Cheryl A. Parks San Antonio, TX	Customer Service Representative RCC Koozie
James E. Stiefvater Conway, AR	Vice President Arkansas Mechanical, Inc.
Diane S. Stipp Bedford, IN	Career Specialist North Lawrence Schools
W. Peter Vorster Paris, AR	Field Auditor State of Arkansas

The National Officers of the Society, serving at December 31, 2003, were as follows:

<u>Name</u>	<u>Office</u>
Cardinal Justin Rigali	National Spiritual Director
Dennis Port, Pastor	Associate National Spiritual Director
John F. Kenawell	National President
**	Vice President Marketing
Richard J. York	National Secretary
Robert J. Goeke	National Treasurer

** - Position is currently vacant

The Society has six established committees. Committee members serving at December 31, 2003, were as follows, with the Chairperson of each committee listed first:

<u>Executive</u>	<u>Investment</u>	<u>Audit</u>
W. Peter Vorster	John F. Kenawell	James E. Stiefvater
John F. Kenawell	Sandra E. Jacobs	Cheryl A. Parks
Thomas E. Diebold	Thomas E. Diebold	Robert N. Dippold
Robert N. Dippold	Diane S. Stipp	Delia A. Arnold
Diane S. Stipp	W. Peter Vorster	W. Peter Vorster
	Robert J. Goeke	Richard J. York
<u>Publication</u>	<u>Merger</u>	<u>Review</u>
Cheryl A. Parks	W. Peter Vorster	Delia A. Arnold
Delia A. Arnold	John F. Kenawell	Robert N. Dippold
Sandra E. Jacobs	Sandra E. Jacobs	W. Peter Vorster
James E. Stiefvater		
Robert N. Dippold		
W. Peter Vorster		

Conflict of Interest

The Society has a policy under which directors, officers and key employees are required to sign a conflict of interest statement each year. Conflict of interest statements for the period under examination were reviewed with no material conflicts of interest noted.

Corporate Records

A review was made of the Articles of Agreement and Bylaws of the Society for the period under examination. The Society amended its Bylaws in 2000 to change the eligibility requirements for serving as a National Representative. In 2003 the Society amended the Bylaws to incorporate a provision requiring the resolution of disputes through binding arbitration. The Director of the Missouri Department of Insurance disapproved this amendment stating that it violated Section 435.350 RSMo, which prohibits mandatory binding arbitration in all insurance contracts, including those of fraternal benefit societies. The Society has subsequently included this amendment in its Bylaws along with a statement that "This Bylaw has not been approved by the Mo. Dept. of Insurance." CKA's contention is that this Bylaw amendment will be applied only in states where it is legal. Currently, no claims have been settled through arbitration.

Section 378.611 RSMo (Amendment of laws, procedures--amendments furnished to members) states that "No amendment to the laws of any domestic society shall take effect unless approved by the director who shall approve such amendment if the director finds that it has been duly adopted and is not inconsistent with any requirement of the laws of this state or with the character, objects and purposes of the society." The Society is therefore directed to remove the amendment from the Bylaws until approval is obtained from the Director of the Missouri Department of Insurance.

CKA could not provide documentation to show that they had provided all members with notice of the 2000 Bylaw amendments as required by Section 378.611 RSMo (Amendment of laws, procedures--amendments furnished to members) which states that "within ninety days from the approval thereof by the director, all such amendments, or a synopsis thereof, shall be furnished to all members of the society either by mail or by publication in full in the official

publication of the society.” CKA is directed to provide notice to its members of any and all Bylaw changes, as prescribed by Section 378.611 RSMo.

Acquisitions, Mergers and Major Corporate Events

Significant corporate events occurring during the examination period involved The Catholic Knights of America Center and are further discussed in the “Affiliated Companies” section of this report.

Surplus Debentures

The Society does not have any surplus debentures issued or outstanding.

AFFILIATED COMPANIES

Holding Company, Subsidiaries and Affiliates

Section 378.623 RSMo (Application of law-exemption from insurance laws) provides that fraternal benefit societies formed under Section 378 RSMo are exempt from the provisions of all other Missouri insurance laws except Chapters 374, 375 and 378 RSMo. As such, CKA’s transactions with affiliates are not subject to the same regulatory oversight as traditional insurance companies. Following is a summary of companies that CKA has relationships with and the agreements / transactions related to each:

The Catholic Knights of America Center

In late 1999, CKA's Trustees formed a corporation known as The Catholic Knights of America Center (The CKA Center). The CKA Center was formed to operate an assisted living center in the Vancroft mansion located on CKA’s West Virginia property. The CKA Center is also used to further the promotion of the CKA fraternal organization. The CKA Center has the

same members and Board of Trustees as the Society, but neither of the entities owns the other. The CKA Center is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code and property taxes from the Brooke County Assessor's Office.

Lease Agreements

After purchasing the Vancroft Mansion-West Virginia property in 1998, CKA leased the entire property to The CKA Center under the terms of a “100% net lease” for \$1 per year. In December 2000, CKA subleased a portion of the West Virginia property from The CKA Center for \$60,000 per year. The leased property consists of an apartment used by CKA’s president, which is leased on an “exclusive use” basis, along with certain other areas of the property that are leased on a “nonexclusive use” basis. This transaction has not been properly disclosed in the Notes to Financial Statements for the years 2000-2003. In addition, the transaction does not appear to meet the terms of being “fair and reasonable” as required by SSAP Number 25 and does not appear to be in the best interest of the policyholders.

Advances (Secured and Unsecured) to The CKA Center

As of December 31, 2003, CKA has advanced The CKA Center over \$715,000 in unsecured receivables. These advances were made to cover operating expenses of The CKA Center, are not collateralized and have no defined terms or date of repayment.

In 2004, CKA advanced The CKA Center \$130,000 in secondary secured notes related to the sale of their home office building described below. CKA also intends to loan The CKA Center an additional \$314,664 in secondary secured notes related to a sale of a portion of the West Virginia property (also described below).

Currently, The CKA Center has negative total net equity of approximately \$660,000. The CKA Center also had negative net income of \$256,183 in 2003. Through discussion with CKA management, it was disclosed that The CKA Center has no formal budget process, that there are no formal review procedures of The CKA Center financial statements and that one individual in West Virginia (the assisted living center director) has control over cash management and most financial reporting aspects. Due to financial instability and control weaknesses, it appears very questionable as to whether CKA will be able to collect these advances. The \$715,000 is reported as a non-admitted asset in the statutory financial statements.

Due to the above financial concerns about The CKA Center, it is again recommended (as it was in the 1999 Report of Financial Examination), that the Board of Trustees review the financial projections of The CKA Center and establish a maximum loss threshold where The CKA Center would be required to obtain independent funding to continue the assisted living operations, or where CKA would consider selling the West Virginia property.

Sale / Leaseback of Home Office Building (2004 Transaction)

In February 2004, CKA sold its home office building to The CKA Center. CKA sold the property to The CKA Center for \$650,000 (CKA financed \$130,000 of the sale price). Immediately following the sale of its home office to The CKA Center in 2004, CKA contributed \$500,000 of the proceeds of this sale to The CKA Center as a donation. \$500,000 represents roughly 38% of CKA's current policyholder surplus, which is a substantial "gift" for a company of this size.

CKA currently leases back 100% of the home office property sold to The CKA Center. The terms of this arrangement do not appear to meet the terms of sale-leaseback accounting as prescribed by SSAP No 22 (Leases) and FAS 98. CKA provided financing of \$130,000 of the

sale under the terms of a 20-year secondary secured Promissory Note. FAS 98 states that in order to use sale-leaseback accounting that the transaction must transfer all of the risks of ownership. Paragraph 12b of FAS 98 states that the risks of ownership are not transferred if “the seller-lessee provides nonrecourse financing to the buyer-lessor for any portion of the sales proceeds or provides recourse financing in which the only recourse is to the leased asset.” As The CKA Center has no other significant unencumbered assets, it appears that the leased asset is CKA’s only recourse for the finance provided. In addition, CKA is subleasing approximately 45% of the property. FAS 98 states that sale-leaseback accounting is not appropriate if the transaction creates continuing involvement provisions or conditions. One of the provisions specified is that the present value of rent for the portion subleased is not more than 10% of the fair value of the asset sold.

It is recommended that the companies take steps to restructure the sales / lease agreements to meet the terms of sale-leaseback accounting or properly account for the gain under the deposit method or as a financing as prescribed by FAS 98.

In March of 2004, The CKA Center received an unsolicited offer from an unrelated party to purchase the St. Louis property for \$740,000. The CKA Center management has provided MDI with a letter stating that if the building is sold to the unrelated party, that it is the intent of The CKA Center to use the net excess sales proceeds to repay CKA for a portion of the \$715,000 in unsecured advances owed to CKA.

Proposed Sale of West Virginia Property (2004 Transaction)

CKA has recently proposed selling approximately 210 acres of the West Virginia property and the Vancroft mansion to The CKA Center for \$680,000 (CKA intends to finance \$340,000 of the sales price). The most recent appraisal (performed for the bank for financing purposes) was completed January 22, 2004, and estimates the portion of the West Virginia property being sold at \$1,500,000. Assuming that the appraisal is credible, CKA is essentially donating another \$820,000 to The CKA Center through this transaction.

Common Cents Credit Union

In 2000, CKA began a relationship with a small credit union with deposits of approximately \$500,000. The Common Cents Credit Union operates out of CKA's home office. CKA provides office space, equipment and all personnel services for the credit union at no cost. Members of the credit union are not required to be members of CKA and members of CKA are not required to join the credit union.

Letter of Understanding and Agreement

The MDI Report of Financial Examination dated August 18, 2000 recommended that CKA and the Common Cents Credit Union form an agreement documenting how costs would be shared as well as stating that funds are not to be commingled. On April 15, 2004, the President of each company signed a "Letter of Understanding and Agreement" stating the CKA would provide space in their home office and assist the credit union with clerical and management responsibilities [at no cost to Common Cents Credit Union]. The letter also requires that there be no commingling of funds between the two organizations.

Catholic Financial Services Corporation

Catholic Financial Services Corporation (CFSC) is an investment advisor and broker/dealer corporation that was formed to market and distribute mutual funds to the Catholic community. CKA entered a Subscription Agreement guaranteeing that they would purchase 40 shares of the Company at a maximum subscription amount of \$60,000. Through 2003, the Society has entered additional subscription agreements and invested a total of \$108,000 in 64 shares of CFSC, which is currently valued at \$3,924 in the Company's financial statement. The Society has also invested in mutual funds managed by CFSC during the examination period (although no investments were owned at December 31, 2003).

Summary of Significant Transactions

The following presentation represents a time summary illustrating significant affiliated transactions along with the history of the Company's policyholder surplus:

December 31, 1998

Policyholder Surplus= \$2,863,826

- The Catholic Knights of America purchased the Vancroft Mansion and West Virginia property for \$755,212.
- CKA paid start-up costs of approximately \$300,000, which was capitalized as part of the WV land.
- Management of CKA formed The Catholic Knights of America Center.
- CKA experienced a net gain from operations of \$45,693.

December 31, 1999

Policyholder Surplus= \$3,025,746

- CKA made unsecured advances to The CKA Center of \$715,163 for operating expenses.
- CKA made capital improvements to the West Virginia property of approximately \$107,000.
- CKA leased the entire West Virginia property to The CKA Center for \$1 per year and subsequently leased-back a portion of the property for \$60,000 per year.
- CKA purchased equipment of \$33,832 to be used for the WV property.
- CKA issued a mortgage loan of \$72,000 to The CKA Center to purchase a "Gate House" appraised at \$92,000 (located next to the WV property).
- CKA "sold" President Kenawell 3.63 acres of the WV property for \$2,000 (classified as additional compensation by the Board of Trustees).
- CKA experienced a net gain from operations of (\$429,950).

December 31, 2003

Policyholder Surplus= \$1,220,905

- CKA sold its home office in St. Louis to The CKA Center for \$650,000.
- CKA donated \$500,000 to The CKA Center.
- The CKA Center approved management to pursue the sale of the home office building to an outside party.
- CKA proposed to sell the Vancroft mansion and a portion of the WV land to The CKA Center at book value of \$629,328 with CKA financing 50% of the sales price.
- CKA's Board of Trustees approved management to initiate discussions with other fraternal organizations regarding a merger.

March 31, 2004

Policyholder Surplus= \$1,027,886

FIDELITY BOND & OTHER INSURANCE

The Society is a named insured on a fidelity bond with coverage loss limits of \$300,000, with a \$2,500 deductible per occurrence. The minimum fidelity coverage that is recommended by the National Association of Insurance Commissioners for a company this size is \$300,000. The Society's coverage meets the suggested minimum amount of fidelity insurance suggested by the National Association of Insurance Commissioner's guidelines.

CKA also maintains the following types of insurance coverages for its property and employees:

<u>Coverage Type</u>	<u>Limit</u>
Directors & Officers Liability	\$ 1,000,000 Annual Aggregate
Workers Compensation	Statutory Limits
Employers Liability-Accident	\$ 100,000 Per Accident
Employers Liability-Disease	\$ 100,000 Per Employee / \$ 500,000 Aggregate
Building-(St. Louis)	\$ 844,800 Aggregate
Building-Personal Property	\$ 298,100 Aggregate
Building-Loss of Income	Actual Loss
Business Liability	\$ 1,000,000 Aggregate
Business-Medical Payments	\$ 5,000 Per Person
Products-Completed Operations	\$ 2,000,000 Aggregate
General Aggregate Liability	\$ 2,000,000 Aggregate
Automobile Coverage-Bodily Injury	\$ 100,000 Per Person / \$ 300,000 Accident
Automobile Coverage-Property Damage	\$ 100,000 Per Accident
Building and Contents-WV Property	\$ 6,341,145 Aggregate
Commercial General Liability-WV Property	\$ 500,000 Aggregate

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

The Catholic Knights of America provides its regular full-time employees with a variety of standard benefits. These benefits include paid holidays/sick/vacation days, major medical insurance, a medical and dental reimbursement plan, accidental death and dismemberment

insurance, group life insurance, short-term and long-term disability insurance, a cafeteria plan and a 401(k) savings and a defined benefit retirement plan.

STATUTORY DEPOSITS

The Society is not required to have funds on deposit with Missouri or any other state.

INSURANCE PRODUCTS AND RELATED PRACTICES

Territory and Plan of Operation

The Society is licensed as a fraternal benefit society with the Missouri Department of Insurance under Chapter 378 RSMo. Its current Certificate of Authority permits the Society to write life, accident and health, and annuity business in the State of Missouri. The Society is also licensed in the following states or districts:

Arkansas	Louisiana	Oklahoma
District of Columbia	Michigan	Pennsylvania
Illinois	Mississippi	Tennessee
Indiana	New Mexico	Texas
Iowa	Ohio	West Virginia
Kentucky		

The Society markets its insurance products through the use of general and independent agents. As of December 31, 2003, the Society had 139 agents under contract. The agents are not captive, but the Society does encourage its agents to make CKA the focus of their sales efforts.

Membership

Membership of the Society may be summarized as follows:

Adult Benefit Membership

Practicing Catholics; eligible to serve as voting members of the National Council, as National Trustees or as the National President.

Associate Member

Baptized Christians of good moral character; cannot serve as voting members of the National Council, as National Trustees or as the National President.

Home Office Members

Individuals who do not participate in membership of any local CKA branch. Home office members are represented at the National Council by the duly elected National Delegates of the State Council in which membership is maintained.

Policy Forms and Underwriting and Insurance Products

All underwriting responsibilities are performed by the Society's Underwriting Department in the home office. The agency force is not allowed to make underwriting decisions; all applications are submitted to the home office underwriting staff for approval. The Society has emulated the underwriting procedures and practices of Munich American Reassurance Company, Generali USA Life Reassurance Company, and Optimum Re Insurance Company, the primary reinsurers of the Society.

The Society offers insurance plans in the following product lines:

1. Individual Traditional Life, which includes a variety of participating permanent and term coverages.
2. Individual Deferred Annuity, which includes a variety of single and flexible premium deferred annuity products.
3. Individual Income Annuity, which includes a variety of life and non-life immediate annuities and settlement options.
4. Individual Health, which consists of a small block of disability income coverages.

Advertising and Sales Materials

The Society markets its products through its agency force, various marketing brochures, newsletters, and through advertisements on Catholic radio stations. The sales staff is encouraged to be present at various branch functions and to have direct contact with members through the various parishes. Direct mail distribution of sales materials is also utilized.

Treatment of Policyholders

In accordance with Missouri Statutes and Regulations, the Society has established a register for complaints filed with the Missouri Department of Insurance. The complaint register was reviewed for the period under examination and appears to contain the required documentation. The Society has historically had very few complaints; consequently, no market conduct examination has ever been conducted on the Society.

REINSURANCE

General

Premiums reported during the period under examination were as follows:

	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Direct - Life & Annuities	\$ 3,740,605	\$ 8,902,238	\$ 4,406,554	\$ 5,914,816
Direct - A&H	20,890	17,608	15,437	13,921
Reinsurance Assumed	-	-	-	-
Reinsurance Ceded	<u>279,954</u>	<u>262,771</u>	<u>274,900</u>	<u>274,382</u>
Net Premiums Earned	<u>\$ 3,481,541</u>	<u>\$ 8,657,075</u>	<u>\$ 4,147,091</u>	<u>\$ 5,654,355</u>

Assumed

The Society did not assume any reinsurance during the period under examination.

Ceded

As of December 31, 2003, the Society had the following reinsurance contracts in place:

Generali USA Life Reassurance Company

Automatic Yearly Renewable Term contract on the Society's Visionlife and Visionflex products with a Society retention of \$50,000 (\$25,000 for insureds age 61 and older). The minimum and maximum cessions per life are \$2,500 and \$350,000 respectively.

Automatic Yearly Renewable Term contract on Accidental Death policies coverage with \$0 retention and a maximum cession of \$300,000 per life. This business is ceded on a Bulk basis; the Society does not submit individual cessions on the business reinsured under this treaty.

Facultative Yearly Renewable Term contracts on individually submitted life policies.

Munich American Reinsurance Company

Yearly Renewable Term contract on whole life products with a Society retention of \$50,000 (\$25,000 for insureds age 61 and over). The minimum and maximum cessions per life of \$2,500 and \$300,000 respectively. The contract also provides that the Society may cede up to \$1,500,000 per life on a facultative basis.

Automatic Coinsurance contract provides automatic coverage on the Society's Annual Renewable Term products. The treaty provides for 50% coinsurance on the first \$100,000 of exposure, and for the reinsurer to assume 100% of the exposure over \$100,000. Both of these figures are reduced by half for insureds age 61 and over. The contract provides for a minimum cession of \$1,000 and a maximum cession of \$500,000. Amounts above \$500,000 are facultative up to a maximum face amount per life of \$35,000,000.

Optimum Re Insurance Company

This agreement provides automatic coverage on the Society's Term 4 Life Product. It provides for 50% coinsurance on the first \$100,000 of exposure, and for Optimum Re to assume 100% of the exposure over \$100,000. Both of these figures are also reduced by half for insureds age 61 and over. The contract provides for a minimum cession of \$5,000 and a maximum of \$350,000. Amounts above \$350,000 are facultative up to a maximum face amount per life of \$4,000,000.

ACCOUNTS AND RECORDS

General

The Society maintains its accounting records on a cash basis through the use of the Life Support Plus system with accruals and statutory adjustments made quarterly and at year-end. Trial balances for the period under review were traced to the general ledger and to the Society's Annual Statements with no material exceptions noted.

Independent Auditor

The Society is audited annually by the CPA firm, Rice, Sullivan & Company, LTD. The 2003 audit workpapers and internal control reports were not available for review at the time the examination fieldwork was completed. The CPA firm did, however, provide copies of bank and investment account confirmations that they received directly from the custodian. These confirmations were relied upon to verify the ownership of these assets.

Independent Actuary

Loss reserves were reviewed and certified by the Society's in-house actuary, Harold T. Cruthis, ASA, MAAA. Annual cash flow testing is performed by Griffith, Ballard and Company. The examiners also engaged an independent actuary, Milliman USA, to perform a review of the Society's reserve calculations and reserving methodologies.

Catholic Knights Scholarship Fund

It was noted that the majority of the "Catholic Knights Scholarship Fund" liability account consists of unclaimed death benefits and other outstanding checks to members written off by CKA. The Society's Bylaws state that any unclaimed benefits of members, which remain unclaimed for a period of two years from the date of its accrual shall be forfeited to the National Scholarship fund or such Society charitable funds as may be designated by the National Board of Trustees. Chapter 447 RSMo supercedes the Society's Bylaws and states that funds unclaimed for more than five years must be remitted to the Missouri Division of Unclaimed Property. The Society is directed to remit all unclaimed property to the state of Missouri in compliance with Sections 447.500-595 RSMo. The total amount of funds unclaimed for more than five years included in the Scholarship fund liability at December 31, 2003 was \$26,313.

FINANCIAL STATEMENTS

The following financial statements, with supporting exhibits, present the financial condition of the Society as of December 31, 2003, and the results of operations for the year then ended. Any examination adjustments to the amounts reported in the annual statement and/or comments regarding such are made in the "Notes to the Financial Statements," which follow the Financial Statements. The failure of any column to add to its respective total is due to rounding or truncation.

There may have been additional differences found in the course of this examination, which are not shown in the "Notes to the Financial Statements." These differences were determined to be immaterial concerning their effect on the financial statements, and therefore were only communicated to the Society and noted in the workpapers for each individual Annual Statement item.

ASSETS

	<u>Ledger & Non-</u> <u>Ledger Assets</u>	<u>Assets</u> <u>Non-Admitted</u>	<u>Net Admitted</u> <u>Assets</u>
Bonds	\$ 43,463,277		\$ 43,463,277
Preferred stocks	2,286,188		2,286,188
Common stocks	16,524		16,524
Mortgage loans on real estate	71,267		71,267
Real estate occupied by the society	880,616		880,616
Real estate held for the production of income	181,497		181,497
Cash and short-term investments	3,398,726		3,398,726
Contract loans	466,326		466,326
Investment income due and accrued	855,929		855,929
Premiums in course of collection	6,387		6,387
Premiums deferred and not yet due	228,878	228,878	-
EDP equipment and software	26,022		26,022
Furniture and equipment	1,423	1,423	-
Society automobiles	10,625	10,625	-
Antiques at CKA Center-West Virginia	76,777		76,777
Amounts due from CKA Center	<u>715,163</u>	<u>715,163</u>	<u>-</u>
Total Assets	<u>\$ 52,685,625</u>	<u>\$ 956,089</u>	<u>\$ 51,729,539</u>

LIABILITIES, SURPLUS AND OTHER FUNDS

	<u>Current Year</u>
Aggregate reserve for life certificates	\$ 43,604,572
Aggregate reserve for accident and health certificates	8,941
Liability for deposit-type contracts	4,062,296
Life certificate and contract claims	149,686
Accident and health certificate and contract claims	2,000
Premiums received in advance	10,194
Interest maintenance reserve	919,891
Commissions to fieldworkers due or accrued	2,982
General expenses due or accrued	26,607
Amounts withheld or retained by society	76,895
Amounts held for fieldworkers' account	950
Remittances and items not allocated	22,243
Asset valuation reserve	297,441
Reserve for exam and convention expense	46,800
Reserve for home office retirement plan	1,236,816
Unpaid reinsurance premium	10,806
Reserve for unused vacation and sick leave	18,181
<u>Reserve for CPA audit</u>	<u>11,334</u>
 Total Liabilities	 <u>\$ 50,508,635</u>
 Unassigned funds (surplus)	 <u>\$ 1,220,904</u>
 Surplus as regards policyholders	 <u>\$ 1,220,904</u>
Total Liabilities and Surplus	<u>\$ 51,729,539</u>

STATEMENT OF INCOME

	<u>Current Year</u>
Premiums and annuity considerations	\$ 5,654,355
Considerations for supplementary contracts with life contingencies	87,914
Net investment income	3,190,675
Amortization of interest maintenance reserve	80,049
Commissions and expense allowances on reinsurance ceded	8,975
Annuity Internal Rollover Consideration	763,674
Miscellaneous income	<u>35,618</u>
Total Income	\$ 9,821,260
Death benefits	\$ 693,762
Matured endowments	18,786
Annuity and old age benefits	3,621,819
Disability, accident and health benefits including premiums waived	2,941
Surrender benefits	190,408
Interest on certificate or contract funds	114,118
Payments on supplementary contracts with life contingencies	131,310
Increase in aggregate reserves for life and A&H certificates	2,612,094
Commissions on premiums and annuity considerations	285,212
General insurance expenses and fraternal expenses	1,620,374
Insurance taxes, licenses and fees	101,027
Increase in loading on deferred and uncollected premiums	(647)
Increase in reserve for national convention and examination	(14,400)
Increase in reserve for home office retirement plan	81,408
Increase in reserve for unused vacation and sick leave	18,181
Increase in reserve for CPA audit	11,334
Annuity Internal Rollover Consideration	763,674
Increase in unpaid reinsurance premium	<u>1,570</u>
Total Expenses	\$ 10,252,971
Net gain from operations before refunds to members	\$ (431,711)
Refunds to members	(1,761)
Net realized capital gains or (losses)	<u>(7,944)</u>
Net Income	<u><u>\$ (437,894)</u></u>

CAPITAL AND SURPLUS

	<u>Current Year</u>
Surplus as regards policyholders, December 31, 2002	\$ 1,910,653
Net income or (loss)	(437,895)
Change in unrealized capital gains or (losses)	25,356
Change in nonadmitted assets	(232,531)
Change in asset valuation reserve	(44,679)
Examination changes	<u>0</u>
Change in surplus as regards policyholders	<u>\$ (689,749)</u>
Surplus as regards policyholders, December 31, 2003	<u><u>\$ 1,220,904</u></u>

NOTES TO FINANCIAL STATEMENTS

None

GENERAL COMMENTS AND/OR RECOMMENDATIONS

Comments Prior Exam-Security Valuation Office Filings

Page 3

It is recommended that the Society take the necessary steps to ensure that all investment owned, that do not meet the new requirements of "Filing Exempt," be properly registered with the Securities Valuation Office of the NAIC.

Corporate Records - Arbitration Bylaw Amendment

Page 9

The Society is directed to remove the amendment regarding the resolution of disputes through binding arbitration from its Bylaws, as the amendment was disapproved by the Director of the Missouri Department of Insurance, as provided for in Section 378.611 RSMo (Amendment of laws, procedures--amendments furnished to members).

Corporate Records - Notice of Bylaw Amendments

Page 9

CKA could not provide documentation to show that they had provided all members with notice of the 2000 Bylaw amendments as required by Missouri statutes. It is recommended that CKA provide notice to its members of any Bylaw changes as prescribed by Section 378.611 RSMo.

Affiliated Companies - Lease Agreements With The CKA Center

Page 9

It is recommended that the Society restructure or reverse its lease agreements with The CKA Center as the current arrangements do not appear to meet the terms of being "fair and reasonable" as required by SSAP Number 25 and does not appear to be in the best interest of the policyholders.

Affiliated Companies - Advances To The CKA Center

Page 11

Due to the financial concerns about The CKA Center, it is again recommended (as was in the 1999 Report of Financial Examination), that the Board of Trustees review the financial projections of The CKA Center and establish a maximum loss threshold where The CKA Center would be required to obtain independent funding to continue the assisted living operations, or where CKA would consider selling the West Virginia property.

Affiliated Companies - 2004 Sale / Leaseback of Home Office

Page 12

It is recommended that CKA and The CKA Center take steps to restructure the sales / leaseback agreements regarding the St. Louis property to meet the terms of sale-leaseback accounting or properly account for the gain under the deposit method or as a financing as prescribed by FAS 98.

Accounts and Records - Catholic Knights Scholarship Fund

Page 23

The Society is directed to remit all unclaimed property to the state of Missouri in compliance with Sections 447.500-595 RSMo. The total amount of funds unclaimed for more than five years included in the Scholarship fund liability at December 31, 2003 was \$26,313.

Subsequent Events / Strategic Plan With Measurable Goals

Page 31

It is recommended that CKA take immediate action to alleviate the drain of surplus and protect the interest of its policyholders. It is recommended that the Board of Trustees and management work together to establish a formal budget / strategic plan with measurable financial goals as well as actions to be taken if these goals are not met in order to ensure that the interests of its policyholders are protected.

SUBSEQUENT EVENTS

In the first quarter of 2004, the following transactions have taken place with The CKA Center. Each of these transactions are described in more detail in the Affiliated Companies section of the report:

- CKA sold its home office building to The CKA Center for \$650,000.
- CKA donated \$500,000 to The CKA Center.
- CKA has proposed selling approximately 210 acres of the West Virginia property and the Vancroft mansion to The CKA Center for \$680,000 (CKA intends to finance \$314,664 of the sales price).
- CKA's Board of Trustees has authorized its management to initiate discussions with other fraternal benefit societies regarding a possible merger.

As noted above, CKA is authorized to transact business in the state of Missouri as a fraternal benefit society under Chapter 378 RSMo, and as such is not subject to the same regulatory oversight as a traditional life insurance company. For comparison purposes, however, it is noted that traditional life insurance companies are required to maintain minimum capital and surplus of \$1,200,000 (pursuant to Section 376.280 RSMo) in order to continue to transact the business of insurance in the state of Missouri.

As of March 31, 2004, The Catholic Knights of America's total unassigned funds (surplus) was \$1,027,886. Unassigned funds as of the date of the last MDI examination was \$3,025,746. This equates to a decrease in unassigned funds of over 66% since 1999. The Society's unassigned funds has decreased by an average of \$451,210 per year during the period under examination. CKA's Board of Trustees and management must take immediate action to help stop the drain of surplus and protect the interest of its policyholders. It is recommended that the Board of Trustees and management work together to establish a formal budget / strategic plan with measurable financial goals as well as actions to be taken if these goals are not met in order to ensure that the interests of its policyholders are protected.



THE CATHOLIC KNIGHTS OF AMERICA

3525 Hampton Avenue • St. Louis, Missouri 63139-1980

Serving Catholic Families since 1877

July 16, 2004

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Kirk Schmidt, CFE, CPA
Chief Financial Examiner
301 West High Street
Room 630
Jefferson City, Missouri 65101

Re: Response to Examination Report

Dear Mr. Schmidt:

We are responding to the Examination Report of The Catholic Knights of America for the period ending December 31, 2003. We wish this response to be included in the report as a public document. The items in our response correspond to the items in the "General Comments and/or Recommendations" section on page 29 of your report.

Comments Prior Exam – Security Valuation Office Filings

We will take the steps necessary to ensure that all investments owned that do not meet the requirements of "Provisionally Exempt Securities" are properly registered with the Securities Valuation Office or, where it is cost prohibitive to do so, include them as admitted assets under the basket clause.

Corporate Records – Arbitration Bylaw Amendment

We have made changes to this bylaw making it enforceable only in states in which it does not violate laws and/or regulations in that state. These changes were approved by our National Delegates and resubmitted to the Director of the Missouri Department of Insurance for approval. We have taken this action to allow us to compete on an equal basis with fraternal from other states that have similar bylaws approved by their State Departments of Insurance allowing them to settle disputes through arbitration.

Corporate Records – Notice of Bylaw Amendments

CKA has provided notice to its members of bylaw changes in the June 2004 issue of their monthly publication.

Affiliated Companies – Lease Agreements with the CKA Center

We do not agree with the Department's opinion that CKA's lease

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agreements with CKA Center do not meet the terms of being fair and reasonable as required by SSAP Number 25. The lease agreement wherein CKA Center leases the total West Virginia property from CKA for \$1 per year was created to give members of CKA, who are also members of CKA Center, a financial advantage through non-assessment of West Virginia property taxes. The lease of certain areas of the property for \$60,000 per year was created to provide monies to pay expenses for those areas of the property used by CKA for fraternal and other activities. The Examination Report states that the leased property consists of an apartment used by CKA's president leased on an "exclusive use" basis, along with certain other areas of the property that are leased on a "nonexclusive basis". Actually, the "apartment" referred to consists of rooms used not only by CKA's president but also by CKA board members, other officers, staff and guests when visiting the property on Society business. Both of these leases were executed with the best interest of the certificate-holders in mind.

Affiliated Companies – Advances to CKA Center

We have met with the Missouri Department of Insurance to establish a maximum loss threshold CKA Center. The Examination Report states that there are no formal review procedures of CKA Center financial statements. To the contrary, the officers are furnished with a complete set of financial information on a monthly basis on which they perform detailed analyses. In addition, the Chairman of the Board of Trustees has received a set of financial reports for his review on no less than a quarterly basis for at least the last two years. In addition, the National President visits the property on a regular basis to review operations and the National Secretary makes annual visits to perform a detailed review of the financial statements.

Affiliated Companies – 2004 Sale/Leaseback of Home Office

CKA Center is currently in negotiations to sell this property to a third party. If this potential sale does not take place, the sale/leaseback agreements will be restructured to meet the terms of sale/leaseback accounting.

Accounts and Records – Catholic Knights Scholarship Fund

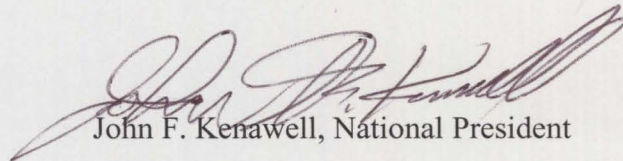
In accordance with the CKA by-laws approved by our National Delegates in their capacity as representatives of our members, all un-cashed benefit checks are to be considered donations to Catholic Knights Scholarship Fund and not unclaimed property reportable to the state of Missouri. All non-benefit un-cashed checks are considered unclaimed property and are reported to the state in compliance with the laws/regulations. Therefore, we believe we are operating in full compliance with the laws/ regulations of the state.

Subsequent Events – Strategic Plan with Measurable Goals

The Board of Trustees and management, as well as the National Delegates, have been aware of the drain on surplus for some time and have been taking actions that should return the Society to profitability. While we have not

yet established a formal budget, we do have formalized plans for the development of a retirement community, subdivision and cemetery in West Virginia which have measurable financial goals. In our estimation, once attained, those goals would result in the CKA Center being self-supporting and in a position to repay funds advanced to it by CKA. We have also developed formal plans with measurable financial results to reduce CKA's expenses. The Board of Trustees and management take very seriously their responsibility of ensuring that the interests of the Society's certificate-holders are protected.

Fraternally,



John F. Kenawell, National President

JFK/ry



THE CATHOLIC KNIGHTS OF AMERICA

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Serving Catholic Families since 1877

JOHN F. KENAWELL
National President

July 29, 2004
Of Our 127th Year

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Kirk Schmidt, CFE/CPA
Chief Financial Examiner
301 West High Street
Room 630
Jefferson City, MO 65101

Dear Mr. Schmidt:

The Catholic Knights of America agrees to the following:

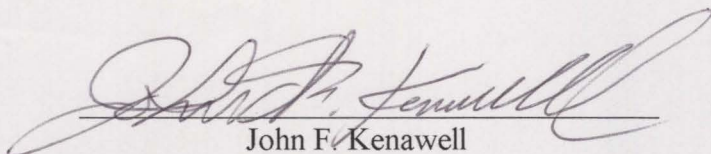
1. CKA will limit its support to the CKA Center to a maximum of \$60,000 from July 15, 2004 to November 15, 2004. Included in this amount will be any travel expenses incurred or reimbursed by CKA for Officers or Directors to travel to the West Virginia property. This \$60,000 will be in addition to the \$10,000 (approximately \$6,300 net of subleases) of rents that are paid monthly to the Center.
2. No additional funds will be paid to or on behalf of the Center, and any other transactions between CKA and the Center will be subject to prior approval of the Department.
3. CKA will commit to using all reasonable efforts to reach a statutory capital and surplus level of \$1.1 million by November 15, 2004.
4. CKA will submit monthly financial statements to the Department including a monthly and year-to-date income statement, as well as a current balance sheet. Along with this monthly financial statement the company will give a total of all advances made to the Center for the month, as well as any additional expenses incurred on behalf of the Center, such as travel. CKA will also provide a written update on any merger talks as well as updates on progress made to achieve the surplus goal.

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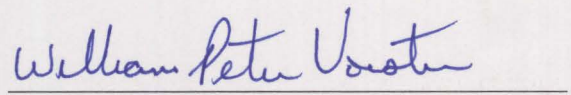
Mr. Kirk Schmidt
Page 2
July 29, 2004

5. The Center will re-pay the second mortgage to CKA upon any sale of the home office to an outside party and will also pay any profits on the sale of this building to CKA for repayment of advances made by CKA. If a sale is not completed by the end of the third quarter CKA will properly account for the initial sale-leaseback of the home office to the Center, based on FAS 98 and SSAP No. 22, or will obtain a written opinion from its independent CPA firm that this transaction has been properly accounted for.

This letter is approved by John F. Kenawell, National President, and William Peter Vorster, National Chairman of the Board.



John F. Kenawell
National President



William Peter Vorster
National Chairman of the Board