

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 78341 / July 15, 2016

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3789 / July 15, 2016

ADMINISTRATIVE PROCEEDING
File No. 3-17345

In the Matter of

The Phoenix Companies, Inc.

Respondent.

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER AND PENALTIES

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), against The Phoenix Companies, Inc. (“Phoenix” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order and Penalties (“Order”), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds¹ that:

Summary

1. On November 8, 2012, Phoenix, a public company with shares traded on the New York Stock Exchange, announced that its previously issued audited financial statements included in Forms 10-K for the years ended December 31, 2011, 2010, and 2009 could no longer be relied upon and would be restated, along with the unaudited financial statements for quarterly periods included in Forms 10-Q going back to March 31, 2011. Phoenix also warned that "[m]anagement will likely conclude that there are one or more material weaknesses" in its disclosure controls and procedures and internal controls over financial reporting.

2. As Phoenix worked through the restatement process of reviewing its previous filings and trying to correct its financials, it discovered, in consultation with its auditors, dozens of additional errors, including basic errors in its calculations, assumptions, and application of accounting guidance to complex insurance products. Some of the errors were due to improper accounting determinations, while others reflected carelessness in the implementation of Phoenix's accounting systems.²

3. On April 1, 2014, Phoenix filed its Form 10-K for the year ended December 31, 2012 (the "Restatement 10-K"), and in this filing Phoenix restated and amended its consolidated financial statements for the years ended December 31, 2011 and 2010. There were several categories of identified errors in the Restatement 10-K, including: 1) Accounting for Certain Universal Life Type Products; 2) Loss Recognition; 3) Fixed Indexed Annuities; and 4) Derivative Valuation. Additionally, Phoenix identified several material weaknesses in internal controls over financial reporting.

¹ The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

² These errors caused further delay in Phoenix's filing of its restated numbers, additional Forms 10-K, and additional Forms 10-Q. On March 21, 2014, the Commission instituted settled cease and desist proceedings which imposed penalties and undertakings for Phoenix to become current in its delinquent periodic filings by November 2014. *See The Phoenix Companies, Inc. and PHL Variable Insurance Company*, Exchange Act Release No. 71768 (Mar. 21, 2014). After Phoenix was unable to meet certain of the deadlines imposed in the undertakings, the Commission amended its March 21, 2014 order by extending the undertakings deadlines to December 2014 and imposing additional penalties, including increasing penalties should Phoenix further delay its filings. *See The Phoenix Companies, Inc. and PHL Variable Insurance Company*, Exchange Act Release No. 72738 (Aug. 1, 2014). Pursuant to the original and amended orders, Phoenix paid \$1.1 million in civil penalties to the Commission.

4. Based on the foregoing, and by the respective acts and omissions described below, Respondent violated the reporting, internal accounting controls, and books-and-records provisions of the federal securities laws.

Respondent

5. The Phoenix Companies, Inc. (“Phoenix”) is a Delaware corporation located in Hartford, Connecticut. Phoenix is a holding company with three insurance company subsidiaries, Phoenix Life Insurance Company, Phoenix Life and Annuity Company, and PHL Variable, which sell life insurance and annuity products. On June 20, 2016, Phoenix merged with a subsidiary of Nassau Reinsurance Group Holdings, L.P. (“Nassau Re”) and became a privately held company and a wholly owned subsidiary of Nassau Re. Before the merger, Phoenix common stock had traded on the New York Stock Exchange (symbol “PNX”) and Phoenix bonds had traded on the New York Stock Exchange (symbol “PFX”).

Facts

A. Phoenix’s Accounting Errors and Impact

6. On April 1, 2014, Phoenix filed its Form 10-K for the year ended December 31, 2012 (the “Restatement 10-K”), including restated and amended numbers for the 2010 and 2011 fiscal years.³ A summary of the impact of the restatement (in millions of dollars) is contained in the table below.

	FY 2012	FY 2011	FY 2010
Original income (loss) from continuing operations before income taxes (\$ mm)	(156.0)	32.0	(34.7)
Restated and amended income (loss) from continuing operations before income taxes (\$ mm)	N/A	2.7	(41.6)
Percent decrease in income (loss) from continuing operations before income taxes (\$ mm)	N/A	92%	20%
Original stockholders' equity (\$ mm)	510.5	1,126.2	1,155.5
Restated stockholders' equity (\$ mm)	N/A	695.7	800.4

³ Phoenix did not file amended Forms 10-K with restated numbers for its fiscal years 2010 and 2011.

7. In the Restatement 10-K, Phoenix identified several categories of restated figures, including: 1) Accounting for Certain Universal Life Type Products; 2) Loss Recognition; 3) Fixed Indexed Annuities; and 4) Derivative Valuation.

B. Errors in Phoenix’s Accounting for Universal Life Insurance Products

8. Certain errors discovered during the restatement process related to accounting for Phoenix’s universal life insurance products. These errors were caused by Phoenix’s improper application of the accounting guidance which was designed to take into account potential future losses on certain insurance products, resulting in a material decrease in net income for fiscal years 2010 and 2011.

9. Phoenix’s universal life products are a form of life insurance with a savings account component. Policyholders pay flexible premiums into the savings account, and the account is credited interest at a predetermined rate. Upon death of the policyholder, the beneficiary receives the face value of the policy or the account value, whichever is greater. Over the life of the policy, Phoenix collects fees from the account for administrative expenses and the “cost of the life insurance” (“COI”). One of Phoenix’s standard universal life products was the Phoenix Accumulator Universal Life (“PAUL”) policy. A PAUL policy was designed as a traditional universal life policy, but would generate higher COI fees in the early years, and lower COI fees in the later years.

10. Starting around 2004, Phoenix began offering a universal life insurance product with a “secondary guarantee” (“SGUL”). Typically, if a universal life policyholder’s account value falls to \$0, the policy lapses, because there are no more funds to pay the administrative fees and the COI fees. The secondary guarantee effectively provided a no-lapse guarantee, as long as certain criteria were met by the policyholder. Should the account value fall to \$0, Phoenix would keep the policy in force while receiving no additional fees. In addition, Phoenix offered certain riders, or add-ons, for its SGUL and PAUL policies, including an extended life rider (“Extended Life Rider”), which charged no premium once a policyholder reached age 100. This again meant that Phoenix would offer life insurance and collect no fees for it, should the policyholder live past 100.

11. Phoenix determined that, by design, the COI feature of the PAUL policies, the secondary guarantees of the SGUL policies, and the Extended Life Rider all were expected to result in profits in earlier years and subsequent losses in later years. In this scenario, the relevant accounting guidance, ASC 944-605-25-8, requires a liability to be established to account for the future losses. ASC 944-40-35-9 through 11 requires this liability to be adjusted using current estimates at each balance sheet date. During the restatement, Phoenix determined that the accounting guidance required that this liability be established with regard to the product’s insurance “benefit features”—not with regard to the product generally, as had previously been done. Phoenix also determined that the higher COI fees in early years and lower COI fees in the later years for the PAUL contracts did not qualify as a “benefit feature,” and therefore a liability should not have been established for this aspect of the contract. In its restatement, Phoenix stated

that it did not properly evaluate certain benefit features and, therefore, did not establish the required reserves.

12. Phoenix was also required to perform a separate premium deficiency analysis under ASC 944-60. In this analysis, Phoenix was required to determine whether the premiums would cover the costs of the contracts. Phoenix tested the premium deficiency for each Phoenix subsidiary and on a consolidated basis. Phoenix determined that no premium deficiency existed. ASC 944-60 also requires a profits followed by losses analysis for each Phoenix line of business and on a consolidated basis. Phoenix did not historically perform the profits followed by losses analysis prescribed by ASC 944-60.

13. A Phoenix actuary analyzing the cash flows in the fall of 2013 as part of the restatement review noticed that a pattern of profits followed by losses existed in Phoenix's universal life business, and determined that the profits followed by losses analysis should have historically been performed.

14. In its pre-restatement application of ASC 944-605-25-8, Phoenix analyzed profits followed by losses over a 30 year period. Phoenix had set this length of time to match the 30 years over which its policies' deferred acquisition costs were amortized. As part of the restatement, Phoenix revisited the assumption, and determined it was appropriate to extend the period of analysis, capturing additional losses in the later years.

15. The universal life products' benefit feature liability decreased when the restated numbers were calculated, but this decrease was more than offset by the increase in the premium deficiency liability. For the 2011 fiscal year, these errors increased liabilities by \$179.4 million and decreased stockholder's equity by \$122.1 million. The errors also decreased net income by \$34.0 million for the 2011 fiscal year (135% of reported income from continuing operations before income taxes). For the 2010 fiscal year, these errors decreased net income by \$46.7 million (106% of reported income from continuing operations before income taxes). By far, the largest impact on Phoenix's 2010 and 2011 financials were the "Accounting for Certain Universal Life Type Products" errors.

C. Errors in Phoenix's Fixed Indexed Annuity Valuation

16. In addition to the universal life products discussed above, Phoenix sold a separate account product called a fixed indexed annuity ("Annuity"). Annuities are insurance products which offer an income stream to the purchaser, typically for life. At the inception of the contract, Annuity purchasers fund an account, often through a lump sum premium payment, which is then credited with interest based on a reference index (e.g., LIBOR) sometimes subject to a cap and floor, over the life of the Annuity. Phoenix sold optional riders for an additional fee, including a guaranteed minimum withdrawal benefit rider. This rider would assure the annuitant a minimal periodic income even if the Annuity account value were to fall to \$0.

17. In the third quarter of 2011, Phoenix set up an internal valuation system to value its Annuity contracts. When Phoenix made the transition to this system, it erroneously included the fees it earned from purchases of the guaranteed minimum withdrawal benefit rider, while

excluding the rider's costs, when estimating its Annuities' gross profits, which caused a \$2.9 million overstatement of earnings for the 2011 fiscal year. Phoenix determined that the inclusion of the rider's fees and exclusion of rider's costs was not in accordance with GAAP,⁴ and Phoenix ultimately concluded that it did not have in place properly designed internal accounting controls, which should have caught this discrepancy.

18. As part of the restatement process, Phoenix scrutinized the internal valuation system's modelling capabilities and determined that the system lacked the functionality to accurately value the Annuities, ultimately finding at least 30 errors within the valuation system relating to a variety of Annuities calculations.

19. These errors included incorrect assumptions regarding policyholder behavior, such as assuming static lapse rates, which were not adjusted based on account value, and assuming withdrawals when it would be disadvantageous for the policyholder to do so. The valuation system also only projected out the Annuities 30 years for valuation purposes, even though certain policyholders' expected lifetimes were longer.

20. Once restated, the identified fixed indexed annuity errors cumulatively caused a \$4.2 million decrease in net income before taxes for fiscal year-end 2011 (13% of reported income from continuing operations before income taxes). Errors related to the Annuity products for the 2010 period resulted in a \$2.3 million net loss (7% of reported income from continuing operations before income taxes) and were classified as "Other Actuarial Errors" in the Restatement 10-K.

D. Error in Phoenix's Reinsurance Accounting

21. Insurance companies often enter into reinsurance contracts to share the risk inherent in a block of policies. Generally, these contracts require the reinsurer to pay a portion (or all) of the expenses associated with a policy or block of policies and the original insurers to pay the reinsurer compensation for entering into the contract. Phoenix entered into two such contracts with a reinsurer in 2008 and 2009, for certain term life policies. These reinsurance contracts allowed Phoenix to reduce its risks associated with its term life business.

22. Phoenix did not perform a premium deficiency analysis on the underlying block of term life policies subject to the reinsurance contracts, as required by the relevant accounting guidance, ASC 944-60. Phoenix assumed that the reinsurer had taken on all of the expenses associated with the term life business. However, the terms of the reinsurance contract only provided for the payment of a portion of these expenses. A subsequent analysis performed as part of the restatement identified a premium deficiency and required Phoenix to establish a liability on its books. This error had the impact of decreasing net income by \$10.6 million for fiscal year-end 2010 (31% of reported income from continuing operations before income taxes) and \$7.6 million for fiscal year-end 2011 (24% of reported income from continuing operations before income taxes).

⁴ ASC 944-60-30.

23. Similar to the Annuity products discussed above, Phoenix also identified errors in the way that its valuation system modelled its reinsurance contracts. Specifically, the valuation system did not have functionality to model multiple reinsurance treaties for a given policy. Once restated, all identified Phoenix's reinsurance accounting errors caused a \$3.3 million decrease in net income for fiscal year-end 2011 (10% of reported income from continuing operations before income taxes), and a \$6.3 million increase in net income for fiscal year-end 2010 (18% of reported income from continuing operations before income taxes).

E. Error in Phoenix's Accounting for Derivatives

24. To hedge certain risks, Phoenix purchased a number of derivatives from, and entered into certain swap agreements with, investment banks. Pre-restatement, Phoenix valued these derivatives and swap agreements without taking a credit valuation adjustment ("CVA"), even though one was required under ASC 815 and 820⁵ to take account of the counterparty risk for these derivatives. The CVA is an allowance which accounts for the default risk of the counterparty.

25. As a result of this error, Phoenix's net income before taxes decreased by \$12.4 million for fiscal year-end 2011 (39% of reported net income before taxes), and \$4.2 million for fiscal year-end 2010 (12% of reported net income before taxes).

Violations

26. As a result of the conduct described above, Phoenix violated Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder.

27. Also as a result of the conduct described above, Phoenix violated Section 13(b)(2)(A) of the Exchange Act, which requires reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

28. Lastly, as a result of the conduct described above, Phoenix violated Section 13(b)(2)(B) of the Exchange Act, which requires all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles.

⁵ ASC 815-20-35-14 and 820-10-35-17 through 10-35-18A.

Phoenix's Remedial Efforts

In determining to accept the Offer, the Commission considered remedial efforts undertaken by Phoenix and cooperation afforded to the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Phoenix's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Phoenix cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act, and Rules 13a-1 and 13a-13 thereunder.

B. Respondent shall, within ninety (90) days of the entry of this Order, pay a civil money penalty in the amount of \$600,000 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Phoenix as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Scott W. Friestad, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, D.C. 20549-5010.

C. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary