

REPORT ON EXAMINATION  
OF THE  
MID-HUDSON CO-OPERATIVE INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2004

DATE OF REPORT:

NOVEMBER 1, 2005

EXAMINER:

GERARD L. FRANCO



STATE OF NEW YORK  
INSURANCE DEPARTMENT  
ONE COMMERCE PLAZA  
ALBANY, NEW YORK 12257

George E. Pataki  
Governor

Howard Mills  
Superintendent

November 1, 2005

Honorable Howard Mills  
Superintendent of Insurance  
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 22384 dated June 1, 2005 attached hereto, I have made an examination into the condition and affairs of the Mid-Hudson Co-operative Insurance Company as of December 31, 2004, and submit the following report thereon.

Wherever the designation "the Company" or "MHCIC" appear herein without qualification, they should be understood to indicate the Mid-Hudson Co-operative Insurance Company.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York Insurance Department.

The examination was conducted at the Company's home office located at 104 Bracken Road Montgomery, New York 12549-2600.

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## 1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1999. This examination covered the five-year period from January 1, 2000 through December 31, 2004, and was limited in scope to these balance sheet items considered by this Department to require analysis, verification or description, including; invested assets, inter-company balances, loss and loss adjustment expense reserves and the provision for reinsurance. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner. The examination included a review of income, disbursements and company records deemed necessary to accomplish such analysis or verification and utilized, to the extent considered appropriate, work performed by the Company's independent public accountants.

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

This report on examination is confined to financial statements and comments on those matters, which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

## 2. DESCRIPTION OF COMPANY

Mid-Hudson Co-operative Insurance Company was incorporated as "The Westchester and Putnam Patrons' Fire Relief Association", as an assessment cooperative, under the laws of the State of New York on April 19, 1900 and commenced operations on September 1 of the same year.

Pursuant to a charter amendment approved by this Department on November 10, 1965, the name of the Company was changed from "The Westchester and Putnam Patrons' Fire Relief Association" to the "Mid-Hudson Co-operative Insurance Company".

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than nine nor more than fifteen members. The board met four times during each calendar year as required by Section 6624(b)(1) of the New York Insurance Law. At December 31, 2004, the board of directors was comprised of the following ten members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Paul Boehme Chatham, NY	Mayor, Village of Chatham, New York
Philip Coombe, Jr. Grahamsville, NY	Retired NYS Superintendent of Corrections and Farmer
Greg M. Cooper Montgomery, NY	Secretary and Treasurer, Mid-Hudson Co-operative Insurance Company; Certified Public Accountant
George Dunkel Pine Bush, NY	Retired President, Community Bank of Sullivan County
Raymond J. Enright Stanfordville, NY	Teacher
Maureen M. Hess Hudson, NY	Secretary, Claverack Co-operative Insurance Co.
Lyle L. Hughes New Hampton, NY	President, Mid-Hudson Co-operative Insurance Company
William J. Lane Monticello, NY	Vice President, Mid-Hudson Co-operative Insurance Company
Alan R. Lewis Newburgh, NY	Lawyer
Gerald J. Skoda Woodburne, NY	Retired Cornell Co-operative Extension Agent

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member has an acceptable record of attendance. The average attendance of the board of directors during the examination period was approximately 92%.

Each of the directors qualifications, as set forth in Article VI of the Company charter and Article II Section I of its by-laws, were reviewed and it appears each director is duly qualified.

As of December 31, 2004, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Lyle L. Hughes	President
Greg M. Cooper	Secretary and Treasurer
William J. Lane	Vice President

B. Territory and Plan of Operation

As of December 31, 2004, the Company was licensed to write business in New York only, excluding the Counties of New York, Kings, Queens, Bronx and Richmond.

As of the examination date, the Company was authorized to transact the kinds of insurance defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

<u>Paragraph</u>	<u>Line of Business</u>
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employer's liability (excluding workers' compensation)
19	Motor vehicle and aircraft physical damage (excluding aircraft physical damage)
20	Marine and inland marine (inland marine only)

The Company was also licensed as of December 31, 2004, to accept and cede reinsurance as provided in Section 6606 of the New York Insurance Law.

The following schedule shows the direct premiums written by the Company in New York for the period under examination:

<u>Calendar Year</u>	<u>Direct Premiums Written</u>
2000	\$3,778,823
2001	3,977,381
2002	4,560,471
2003	5,568,048
2004	6,127,107

Based on the lines of business for which the Company is licensed and the Company's current capital structure, and pursuant to the requirements of Article 66 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$100,000.

At December 31, 2004, the Company wrote insurance through approximately 85 independent agents and 11 brokers.

The Company's predominate lines of business are commercial multiple peril, homeowners multiple peril and fire which accounted for 50.6%, 28.5% and 11.7%, respectively, of the Company's 2004 direct written business.

C. Reinsurance

During the period covered by this examination, the Company did not assume any reinsurance business.

The company has structured its ceded reinsurance program to limit its maximum exposure to any one risk as follows:

Property Lines 2 layers	\$400,000 in excess of \$100,000 as respects any one risk, liability of reinsurer not to exceed \$450,000 and \$750,000 for 1 <sup>st</sup> and 2 <sup>nd</sup> layers, respectively, by reason of any one loss occurrence;
Casualty Lines 3 layers	\$910,000 in excess of \$90,000 as respects any one loss occurrence;
Casualty Clash	\$2,000,000 in excess of \$1,000,000 in any one loss occurrence;
Property Facultative	Limited to three (3) times the net retained liability of the Company, subject to a maximum cession of \$750,000 and a minimum retention of \$250,000 as respects any one risk;
Special Casualty Excess of Loss	\$500,000 combined net loss in excess of \$500,000 ultimate net loss each loss occurrence;
Property catastrophe 4 layers	95% of \$2,900,000 in excess of \$100,000 ultimate net loss each loss occurrence;  100% in excess of \$3,000,000 ultimate net loss each loss occurrence;
Aggregate	95% of \$500,000 of the amount, if any, by which the aggregate net losses for any one agreement year exceeds an amount equal to 84% of net earned premium income during each agreement year.

With the exception of 2003, the Company used authorized reinsurers for all years of the examination period. In 2003, the Company used a reinsurance intermediary and one of the reinsurers was not authorized. The unauthorized reinsurer's participation under the reinsurance contract was 20%. It is noted that the Company has been informed that all reinsurers used on reinsurance contracts must be authorized in New York, as required by Section 6606 of the New York Insurance Law.

Section 1308(e)(1)(A) of the New York Insurance Law provides, that during any period of twelve consecutive months, without the superintendent's permission, no domestic insurer, except life, may by any reinsurance agreement or agreements cede an amount of its insurance on

which total gross reinsurance premiums are more than fifty percent of the unearned premiums on the net amount of its insurance in force at the beginning of such period.

Through the review of the Company's annual statement for the examination period, it was determined that for all years the 50% limitation set forth in Section 1308(e)(1)(A) was exceeded. During the period covered by this examination, the Company failed to submit to the Department for review various reinsurance agreements, and subsequent amendments to the reinsurance agreements, as required by Section 1308(e)(1)(A) of the Insurance Law.

It is recommended that the Company comply with the requirements of Section 1308(e)(1)(A) of the New York Insurance Law and file all reinsurance contracts and addenda with the Department.

It is noted that prior to the completion of the examination the Company submitted to the Department all reinsurance contracts effective January 1, 2005.

All ceded reinsurance agreements in effect as of the examination date were reviewed and found to contain the required clauses, including an insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law.

Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62. Representations were supported by an attestation from the Company's Chief Executive Officer pursuant to Department Circular Letter No. 8 (2005). Additionally, examination review indicated that the Company was not a party to any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in paragraph 25 of SSAP No. 62.

D. Holding Company System

The Company was independent with no affiliations at December 31, 2004. It is not a member of any holding company system.

E. Abandoned Property Law

Section 1316 of the New York State Abandoned Property Law provides that amounts payable to a resident of this state from a policy of insurance, if unclaimed for three years, shall be deemed abandoned property. Such abandoned property shall be reported to the comptroller on or before the first day of April each year. Such filing is required of all insurers regardless of whether or not they have any abandoned property to report.

The Company's abandoned property reports for the period of this examination were all filed on a timely basis pursuant to the provisions of Section 1316 of the New York State Abandoned Property Law.

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 2004, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	68%
Liabilities to liquid assets(cash and invested Assets less investments in affiliates)	49%
Premiums in course of collection to surplus as regards policyholders	1%

All of the above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information Systems of the National Association of Insurance Commissioners.

The underwriting ratios presented below are on a earned/incurred basis and encompass the five-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$9,441,629	70.30%
Other underwriting expenses incurred	4,991,152	37.17%
Net underwriting loss	<u>(1,003,087)</u>	<u>(7.47)</u>
Premiums earned	<u>\$13,429,694</u>	<u>100.00%</u>

G. Accounts and Records

i. Check Signing by Non-Officers

Section 6611(a)(4)(C) of the New York Insurance Law states; "All checks issued shall be signed either by two officers or by one officer upon the written order of another officer, except as otherwise provided by resolution of the corporation's board of directors or in its by-laws for handling of miscellaneous expenses."

At the Board of Directors' meeting held April 26, 2000, approval was given to list the Controller as a signatory. Also, at the July 30, 2003 Board of Directors' meeting authorization was given to the claims manager to sign checks up to \$5,000.

As neither the Controller nor the claims manager are officer positions, the Company is in violation of Section 6611(a)(4)(C) of the Insurance Law. Therefore, it is recommended that the Company comply with Section 6611(a)(4)(C) of the New York Insurance Law and permit only officers of the Company to sign checks.

ii. Custodial Agreement

After a review of the Company's current custodial agreement, several provisions and safeguards required by Department guidelines, as suggested in the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook, reinforced by the

Department's Circular Letter No. 2 of 1977, were not included in the agreement. Therefore, it is recommended that the Company comply with Department guidelines, as suggested by NAIC guidelines, reinforced by Circular Letter No. 2 of 1977 and obtain a custodial agreement that includes the requirements suggested by the NAIC and New York Insurance Department.

Before the examination was completed, the Company management had contacted the custodial bank and is in the process of revising the custodial agreement to comply with the requirements specified by the NAIC and the New York Insurance Department.

3. FINANCIAL STATEMENTSA. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2004 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$6,823,584	\$ 0	\$6,823,584
Preferred stocks	51,188	0	51,188
Common stocks	1,389,746	0	1,389,746
Properties occupied by the company	280,705	0	280,705
Cash, cash equivalents, and short-term Investments	<u>961,467</u>	<u>0</u>	<u>961,467</u>
Subtotals, cash and invested assets	\$9,506,690	\$ 0	\$9,506,690
Investment income due and accrued	80,575	0	80,575
Uncollected premiums and agents' balances in the course of collection	166,222	96,096	70,126
Deferred premiums, agents' balances and installments booked but deferred and not yet due	1,212,248	0	1,212,248
Net deferred tax assets	208,999	0	208,999
Electronic data processing equipment and software	33,674	33,674	0
Other assets non admitted	<u>16,727</u>	<u>16,727</u>	<u>0</u>
Totals	<u>\$11,225,135</u>	<u>\$146,497</u>	<u>\$11,078,638</u>

Liabilities, surplus and other funds

Losses and loss adjustment expenses		\$1,817,122
Commission payable,contingent commissions and other similar Charges		471,378
Other expenses (excluding taxes, licenses and fees)		98,145
Taxes,licenses and fees (excluding federal and foreign income taxes		6,800
Current federal and foreign income taxes		120,000
Unearned premiums		2,986,912
Ceded reinsurance premiums payable (net of ceding commissions)		195,327
Remittance and items not allocated		57,380
Aggregate write-ins for liabilities		<u>2,033</u>
Total liabilities		\$5,755,097
Aggregate write-ins for special surplus funds	\$ 100,000	
Unassigned funds (surplus)	<u>5,223,541</u>	
Surplus as regards policyholders		<u>5,323,541</u>
Totals		<u>\$11,078,638</u>

Note: The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2000-2004. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$725,537 during the five-year examination period January 1, 2000 through December 31, 2004, detailed as follows:

Underwriting Income

Premiums earned		\$13,429,694
Deductions:		
Losses and loss adjustment expenses incurred	\$9,441,629	
Other underwriting expenses incurred	4,970,759	
Aggregate write-ins for underwriting deductions	<u>20,393</u>	
Total underwriting deductions		<u>14,432,781</u>
Net underwriting gain or (loss)		\$(1,003,087)

Investment Income

Net investment income earned	\$1,650,256	
Net realized capital gain	<u>(178,959)</u>	
Net investment gain or (loss)		1,471,297

Other Income

Net gain or (loss) from agents' or premium balances charged off	(88,149)	
Finance and service charges not included in premiums	270,042	
Aggregate write-ins for miscellaneous income	<u>0</u>	
Total other Income		<u>\$ 181,893</u>
Net income after dividends to policyholders but before federal And foreign income taxes		\$ 650,103
Federal and foreign income taxes incurred		<u>257,577</u>
Net Income		<u>\$ 392,526</u>

Surplus as regards policyholders per report on examination as of December 31, 1999			\$4,598,004
	<u>Gains in</u> <u>Surplus</u>	<u>Losses in</u> <u>Surplus</u>	
Net income	\$392,526	\$-0-	
Net unrealized capital gains or (losses)	51,919	-0-	
Change in net deferred income tax	52,965	-0-	
Change in nonadmitted assets	13,233	-0-	
Cumulative effect of changes in accounting principles	58,861	-0-	
Aggregate write-ins for gains and losses in surplus	<u>156,033</u>	<u>-0-</u>	
Net increase in surplus			<u>\$ 725,537</u>
Surplus as regards policyholders per report on examination as of December 31, 2004			<u>\$5,323,541</u>

#### 4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$1,817,122 is the same as reported by the Company as of December 31, 2004. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Companies internal records and in it filed annual statements.

#### 5. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the more precise scope of a market conduct investigation, which is the responsibility of the Market Conduct Unit of the Property Bureau of this Department.

The general review was directed at practices of the Company in the following areas:

- A. Sales and advertising
- B. Underwriting
- C. Rating
- D. Claims and complaint handling

Fourteen claim files were reviewed in the examination of the treatment of policyholders. Nine of the files reviewed were applicable to this Department's Regulation No. 95(NYCRR Part 86.4) which requires that a fraud warning statement be placed on claim forms sent to a claimant. Six out of the nine files were not in complete compliance with Regulation 95. The Proof of Loss statement contained in three of the files did not include any fraud warning statement, while in another three the fraud warning statement wording was not correct. It is recommended that the Company comply with the Department's Regulation No. 95(NYCRR Part 86.4) and include a fraud warning statement on all claims forms sent to a claimant.

The Company has taken steps to include the proper fraud statement wording on all Proof of Loss statements.

A sample of fourteen claim files were reviewed regarding Company compliance with Section 318(a) of the New York Insurance Law and this Department's Regulation No. 96(NYCRR Part 62-2.2). In the review it was determined that five of these files were applicable to Section 318(a) of the New York Insurance Law. Section 318(a) states,"(a) Insurers shall report all fire losses in excess of five hundred dollars or such larger amount as prescribed by the superintendent, arising under policies covering property located in this state to a central organization engaged in property loss registration, as designated by the superintendent, in accordance with regulations promulgated by the superintendent." There was no indication found in the five files reviewed that fire losses over \$1,000, as required by Regulation No. 96(NYCRR

Part 62-2.2), were reported to the Property Insurance Loss Register (PILR). Therefore, it is recommended that the Company comply with Section 318(a) of the New York Insurance Law and Regulation 96(NYCRR Part 62-2.2) and report all fire losses in excess of \$1,000 to the Property Insurance Loss Register.

A sample of fourteen claim files were reviewed regarding Company compliance with Section 3413 of the New York Insurance Law and Regulation No. 96(NYCRR Parts 62-3.2 and 62.5.3 require that standard claim forms be completed by claimants on all fire losses. It was determined from the review that the Company was not in complete compliance with Parts 62-3.2 and 62-5.3 as not all files contained Parts 1, 2 and 3 of the standard claim forms as required, where applicable. It is recommended that the Company comply with Section 3413 of the New York Insurance Law and Regulation 96(NYCRR Part 62) and have Parts 1, 2 and 3 of the standard claim forms completed by the claimant included in the claim file, when applicable.

It is noted that before the examination was completed the Company has instituted procedures whereby all standard fire claim forms will be completed and included in all claim files where applicable.

As sample of fourteen claims, files were reviewed regarding Company compliance with Section 331 of the New York Insurance Law and Circular Letter 34 of 1999. In the review, it was determined that three of these files were applicable. Section 331 and Circular Letter 34 of 1999 require the Company, before proceeding with payment on fire losses, to give written notice to Tax Districts who have filed with the Department notice of intent to claim against fire insurance proceeds. In the three files reviewed, no notice was given to the Tax Districts, who had filed their intent to claim against fire insurance proceeds with the Department. It is recommended the Company comply with Section 331 of the New York Insurance Law and Circular Letter 34 of 1999 and before payment is made on fire losses send written notice to Tax

Districts who have informed the Department of their intent to claim against fire insurance proceeds.

It is noted that before the examination was completed the Company has instituted procedures whereby all Tax Districts will be notified, where applicable, to comply with the above cited Insurance Law and Circular Letter.

A review of the four agent termination letters sent out during the examination period showed that only the termination in 2004 complied with all sections of Part 218 of this Department's Regulation No. 90. The other three were not in complete compliance with Regulation 90, by not giving either the agent the required 30 days notice (Part 218.4(b)), nor the required notice for the filing of complaints (Part 218.5(a)), redlining notice, or a specific reason (Part 218.4(a)).

Although the Company began to comply with Regulation 90 in 2004, it is recommended that the Company continue its compliance with all Parts of Regulation 90, particularly with Parts 218.4(a) and (b) and 218.5(a), henceforth, when sending out notices of termination to agents or brokers.

#### 6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained four recommendations as follows (page numbers refer to the prior report):

ITEM	PAGE NO.
A. <u>Management</u>	
i. It is recommended that the Company comply with its by-laws and make certain that a director elected to the board is a member of the Company	4-5

The Company has complied with this recommendation.

- ii. It is recommended that the Company fully comply with Section 1411(a) of the New York Insurance Law and that the Board exercise due care in approving the investment transactions. 4-5

The Company has complied with this recommendation.

B. Reinsurance Contracts

- It is recommended that the Company revise the reinsurance contracts to comply with New York permitted practices. 8

The Company has complied with this recommendation.

C. Accounts and records

- It is recommended that the Company comply with the NAIC Annual Statement Instructions when preparing Schedule A of the annual statement. 11

The Company has complied with this recommendation.

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Reinsurance contracts</u>	
It is recommended that the Company comply with requirements of Section 1308(e)(1)(A) of the New York Insurance Law and file all reinsurance contracts and addenda with the Department.	7
B. <u>Accounts and records</u>	
i. It is recommended that the Company comply with Section 6611(a)(4)(C) of the New York Insurance Law and permit only officers of the Company to sign checks.	9
ii. It is recommended that the Company comply with Department guidelines, as suggested by NAIC guidelines, reinforced by Circular Letter No. 2 of 1977 and obtain a custodial agreement that includes the requirements suggested by the NAIC and the New York Insurance Department.	10
C. <u>Market Conduct Activities</u>	
i. It is recommended that the company comply with the Department's Regulation No. 95 (NYCRR Part 86.4) and include a fraud warning statement on all forms sent to a claimant.	15

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- ii. It is recommended that the Company comply with Section 318(a) of the New York Insurance Law and Regulation 96 (NYCRR Part 62-2.2) and report all fire losses in excess of \$1,000 to the Property Insurance Loss Register. 16
- iii. It is recommended that the Company comply with Section 3413 of the New York Insurance Law and Regulation 96 (NYCRR Part 62) and have completed by the claimant Parts 1, 2 and 3 of the standard claim forms included in the claim file, when applicable. 16
- iv. It is recommended that the Company comply with Section 331 of the New York Insurance Law and Circular Letter 34 of 1999 and before payment is made on fire losses send written notice to Tax Districts who have informed the Department of their intent to claim against fire insurance proceeds. 16-17
- v. Although the Company began to comply with Regulation 90 in 2004, it is recommended that the Company continue its compliance with all Parts of Regulation 90, particularly with Parts 218.4(a) and (b) and 218.5(a), henceforth, when sending out notices of termination to agents or brokers. 17

Respectfully submitted,

5/S  
Gerard L. Franco, CIE  
Senior Insurance Examiner

STATE OF NEW YORK     )  
  )SS:  
  )  
COUNTY OF ALBANY    )

Gerard L. Franco, being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.

3/S  
Gerard L. Franco

Subscribed and sworn to before me  
this 7TH day of NOVEMBER, 2005.

5/S  
DIANNE M. BURKE  
Notary Public, State of New York  
Qualified in Albany County  
No. 01BU5076509  
Commission Expires April 21, 2007

STATE OF NEW YORK  
INSURANCE DEPARTMENT

I, Howard Mills, Superintendent of Insurance of the State of New York,  
pursuant to the provisions of the Insurance Law, do hereby appoint:

**Gerard Franco**

*as proper person to examine into the affairs of the*

**Mid-Hudson Co-Operative Insurance Company**

*and to make a report to me in writing of the condition of the said*

**Company**

*with such other information as he shall deem requisite.*

*In Witness Whereof, I have hereunto subscribed by the  
name and affixed the official Seal of this Department, at  
the City of Albany,*

*this 1<sup>st</sup> day of June 2005*



A handwritten signature in cursive script, appearing to read "Howard Mills".

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Howard Mills  
Superintendent of Insurance