

REPORT ON EXAMINATION

OF THE

COUNTRYWAY INSURANCE COMPANY

AS OF

DECEMBER 31, 2004

DATE OF REPORT

JANUARY 30, 2006

EXAMINER

SHEIK H. MOHAMED

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STATE OF NEW YORK  
INSURANCE DEPARTMENT  
25 BEAVER STREET  
NEW YORK, NEW YORK 10004

January 30, 2006

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 22353 dated April 1, 2005 attached hereto, I have made an examination into the condition and affairs of the Countryway Insurance Company as of December 31, 2004, and submit the following report thereon.

Wherever the designations "the Company" or "CIC" appear herein without qualification, they should be understood to indicate Countryway 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 5794 Widewaters Parkway, DeWitt, New York 13214.

## 1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 2000. This examination covered the four-year period from January 1, 2001 through December 31, 2004. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner. The examination comprised a verification of assets and liabilities as of December 31, 2004, a review of income and disbursements deemed necessary to accomplish such verification and utilized, to the extent considered appropriate, work performed by the Company's independent certified public accountants. A review or audit was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners ("NAIC"):

- History of Company
- Management and control
- Corporate records
- Fidelity bond and other insurance
- Territory and plan of operation
- Growth of Company
- Business in force by states
- Loss experience
- Reinsurance
- Accounts and records
- Financial statements
- Market conduct activities

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

Countryway Insurance Company was incorporated in 1954 under the laws of the State of New York as the Grange League Federation Insurance Company (“GLF”) to write insurance on the properties and risks of its parent company, the Cooperative Grange League Federation Exchange, Inc. In 1964, the Cooperative Grange League Federation Exchange, Inc. merged with two other cooperatives to form the parent company, Agway, Inc., a Delaware corporation. In 1966, GLF changed its name to Agway Insurance Company. Effective August 28, 2002, the Agway Insurance Company was acquired by United Farm Family Mutual Insurance Company and the company was renamed Countryway Insurance Company.

Capital paid in was \$5,300,000 consisting of 265,000 shares of \$20 par value per share common stock. Gross paid in and contributed surplus is \$28,166,983. Gross paid in and contributed surplus increased by \$2,456,383 during the examination period, as follows:

<u>Year</u>	<u>Description</u>		<u>Amount</u>
2001	Beginning gross paid in and contributed surplus		\$25,710,600
2002	Surplus contribution	\$ 266,390	
2002	Contributed fixed assets	2,184,482	
2004	Surplus contribution	<u>5,511</u>	
	Total Surplus Contributions		<u>2,456,383</u>
2004	Ending gross paid in and contributed surplus		<u>\$28,166,983</u>

### 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 thirteen nor more than thirty-five members. The board met four times during each calendar year. At December 31, 2004, the board of directors was comprised of the following twelve members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Joseph Jerry Canada Indianapolis, IN	Executive Vice President and Chief Executive Officer, Indiana Farm Bureau Insurance Companies
George Edward Corya Commiskey, IN	Farmer

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Carolyn Joan Donson Kokomo, IN	Farmer
Leanne Frances Fiscoe Camillus, NY	Vice President, Chief Financial Officer and Treasurer, Countryway Insurance Company
Carolyn Marie Hegel Indianapolis, IN	Second Vice President, Indiana Farm Bureau, Inc.
Randall Charles William Kron Evansville, IN	Vice President, Indiana Farm Bureau, Inc.
Donald David Lawson Thorntown, IN	Farmer
Gary Thomas Reding Greensburg, IN	Farmer and Owner, Langeland Farms, Inc.
James Peter Rink Baldwinsville, NY	Senior Vice President, Countryway Insurance Company
Gerald Roy Seeber Baldwinsville, NY	Executive Vice President and Chief Executive Officer, Countryway Insurance Company
Donald Bruce Villwock Indianapolis, IN	President, Indiana Farm Bureau, Inc. and subsidiaries
Gerald Robert Wright Indianapolis, IN	Senior Vice President, United Farm Family Mutual Insurance Company and UFB Casualty Insurance Company

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.

As noted above the board of directors as of December 31, 2004 was comprised of only twelve members, instead of the minimum of thirteen required by the Company's charter and by-laws. A vacancy on the Company's board of directors was created by the resignation of Martin Lee Yoder on December

18, 2004. That vacancy was filled in February 2005 when Kendell Culp was appointed to the Company's board of directors.

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

<u>Name</u>	<u>Title</u>
Donald Bruce Villwock	President
Lynn Brundage Jongleux	Secretary
Leanne Frances Fiscoe	Vice President, Chief Financial Officer and Treasurer
Michael Charles Phillips	Vice President, Claims
James Peter Rink	Senior Vice President, Operations
Gerald Roy Seeber	Executive Vice President and Chief Executive Officer

B. Territory and Plan of Operation

As of December 31, 2004, the Company was licensed to write business in seventeen states as follows:

Connecticut	Massachusetts	Pennsylvania
Delaware	Missouri	Rhode Island
Indiana	New Hampshire	Tennessee
Kentucky	New Jersey	Vermont
Maine	New York	Virginia
Maryland	Ohio	

Approximately 76% of the Company's direct writings in 2004 were concentrated in Kentucky, New York and Pennsylvania.

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

<u>Paragraph</u>	<u>Line of Business</u>
3	Accident & health
4	Fire
5	Miscellaneous property damage
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
10	Elevator
11	Animal
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
16	Fidelity and surety
17	Credit
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity

In addition, the Company is licensed to transact such workers' compensation insurance as may be incidental to coverages contemplated under paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law, including insurances described in the Longshoreman's and Harbor Workers' Compensation Act (Public Law No. 803, 69 Cong. as amended; 33 USC Section 901 et seq. as amended).

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 Articles 13 and 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$2,200,000.

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

DIRECT WRITTEN PREMIUMS

<u>Calendar Year</u>	<u>New York State</u>	<u>Total United States</u>	<u>Premiums Written in New York State as a percentage of United States Premiums Written</u>
2001	\$8,388,768	\$31,584,661	26.56%
2002	\$8,714,164	\$33,482,948	26.03%
2003	\$8,875,020	\$36,697,279	24.18%
2004	\$9,667,753	\$38,285,270	25.25%

The Company obtains business through approximately 350 independent agents as of December 31, 2004. Additionally, the Company participates in various pools, associations, syndicates and FAIR plans throughout the United States.

C. Reinsurance

Assumed reinsurance accounted for less than 1% of the Company's gross written premiums at December 31, 2004. During the period covered by this examination, the Company's assumed reinsurance business has remained stable, with minimal change from the last examination. The Company's assumed reinsurance program consists solely of coverages assumed from various mandated pools. The Company utilizes reinsurance accounting as defined in Statement of Statutory Accounting Principles ("SSAP") No. 62 for all of its assumed reinsurance business.

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

- Property Lines – Excess of loss reinsurance above \$175,000 up to \$3,000,000 is maintained on all property lines. Facultative property coverage is maintained for all limits in excess of \$3,000,000. The Company also has an excess of loss catastrophe cover above \$500,000 per event up to \$7,000,000 (95% cover) and an additional layer of earthquake protection up to \$12,000,000 (95% cover). An occurrence property catastrophe contract provides terrorism coverage of \$1,000,000 above a \$500,000 retention.
- Casualty Lines – Excess of loss reinsurance provides coverage above \$150,000 up to \$16,500,000 on all casualty lines. Also in place is personal and commercial umbrella coverage with 10% retention on the first \$1,000,000 and 0% retention for layers above \$1,000,000 up to \$5,000,000.

During the period under examination, a majority of the business was ceded to authorized reinsurers. Cessions to authorized companies have increased since the last examination. In fact, in 2004, 100% of the cessions were to authorized reinsurers.

It is the Company's policy to obtain the appropriate collateral for its cessions to unauthorized reinsurers. Letters of credit obtained by the Company to take credit for cessions to unauthorized reinsurers were reviewed for compliance with Department Regulation 133. No exceptions were noted.

All ceded reinsurance agreements entered into during 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, except as follows:

i. Offset Clause

A review of all of the 2004 ceded reinsurance contracts revealed that the offset clause includes the following sentence,

“American and Reinsured may offset any balance or amount due from one party to the other under this agreement or any other reinsurance agreement previously or hereafter executed, (Emphasis added) whether acting as the reinsurer or the ceding company.”

Whenever a reinsurance agreement contains such broad rights to offset, this Department requires that the following language be included:

“In the event of the insolvency of either party to this agreement then offsets shall only be allowed to the extent permitted by the provisions of Section 7427 of the New York Insurance Law.”

It was noted that when this matter was brought to the Company's attention, amendments to its 2004 ceded reinsurance contracts were effected to include the required language.

It is recommended that in the future the Company ensure that all ceded reinsurance agreements to which it is a party, containing broad rights to offset include the language required by this Department.

ii. Entire Contract Clause

In accordance with SSAP No. 62, paragraph 8(c),

“The agreement shall constitute the entire contract between the parties and must provide no guarantee of profit, directly or indirectly, from the reinsurer to the ceding entity or from the ceding entity to the reinsurer.”

The years 2003 and 2004 ceded reinsurance contracts did not include the entire contract clause. When this matter was brought to the Company’s attention, amendments to its 2003 and 2004 reinsurance contracts were effected to include the entire contract clause.

It is recommended that in the future the Company comply with the requirements of SSAP No. 62, paragraph 8(c) and ensure that all ceded reinsurance contracts to which it is a party include the entire contract clause.

Examination of the Schedule F data reported by the Company in its 2004 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 Executive Vice President / Chief Executive Officer as well as the Company’s Senior Vice President / Chief Operating Officer / Treasurer pursuant to Department Circular Letter No. 8 (2005). Additionally, the examination review did not identify any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in paragraphs 25 and 26 of SSAP No. 62.

During the period covered by this examination, the Company commuted a reinsurance agreement in which it was the assuming reinsurer. This commutation resulted in a minimal gain to the Company's surplus.

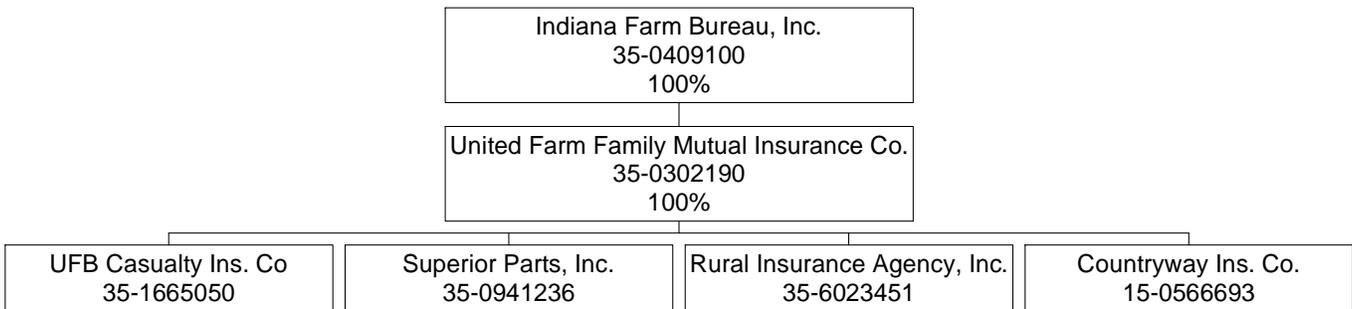
D. Holding Company System

The Company is a member of the Indiana Farm Bureau Group. The Company is 100% owned by United Farm Family Mutual Insurance Company (“UFFMIC”), an Indiana corporation, which is ultimately controlled by Indiana Farm Bureau, Inc.

A review of the holding company registration statements filed with this Department indicated that such filings were complete and were filed in a timely manner except for the 2002 and 2003 statements, which were filed on February 24, 2005. Pursuant to Part 80-1.4 of Regulation 52, all controlled insurers are required to file an annual holding company registration statement (Form HC-1) within 120 days following the end of its ultimate holding company's fiscal year.

It is recommended that the Company file its annual holding company registration statements in a timely manner pursuant to the provisions of Part 80-1.4 of Department Regulation 52.

The following is an abbreviated chart of the holding company system at December 31, 2004.



At December 31, 2004, the Company was party to the following agreements with other members of its holding company system:

1. Service Agreement

CIC and UFFMIC entered into a services agreement in which UFFMIC would provide CIC with access to various support services including, but not limited to, actuarial, payroll and benefit administration, legal and electronic data processing/information services. This agreement became effective August 29, 2002, and was non-disapproved by the Department on August 21, 2002.

2. Tax Allocation Agreements

CIC has a written tax allocation agreement with its Parent, UFFMIC. The tax allocation is based upon separate return calculations. Settlements under the agreement are made within 30 days of filing the applicable estimated or actual consolidated federal corporate tax return. The Company has filed the tax allocation agreement in accordance with Department Circular Letter No. 33 (1979).

Pursuant to Item 2 of this agreement:

"An escrow account shall be established and maintained by Farm Bureau in an amount equal to the difference, if any, between (i) the amount determined in accordance with paragraph 1 above, and (ii) the actual payment made by Farm Bureau to the Internal Revenue Service".

Also, effective August 29, 2002, Countryway Insurance Company entered into an escrow agreement with United Farm Family Mutual Insurance Company ("Farm Bureau"). Pursuant to Item 1 under this agreement:

"The monies held by Farm Bureau, as computed under the terms of the Tax Allocation Agreement dated of even date herewith will be held in an escrow account **as an accounting entry on the books of Farm Bureau** (emphasis added)".

Both agreements were non-disapproved by the Department on August 21, 2002 as part of the acquisition of control of the Company. These agreements were part of the application.

An accounting entry on the books of the parent would not satisfy the requirements of Department Circular Letter 33 (1979), which states, in part:

"To help assure the domestic insurer's enforceable right to recoup federal income taxes in the event of future net losses an escrow account consisting of assets eligible as an investment for the domestic insurer shall be established and maintained by the parent in an amount equal to the excess of the amount paid by the domestic insurer to the parent for federal income taxes over the actual payment made by the parent to the Internal Revenue Service."

Escrow is defined as:

"Money, property, a deed, or a bond put into the custody of a third party for delivery to a grantee only after the fulfillment of the conditions specified".

By having the "escrow" account only as an accounting entry on the books of the parent, it does not help to assure the domestic insurer's enforceable right to recoup its federal taxes as required by the circular letter. The escrow has to be in a separate account in a bank or trust company, with Countryway Insurance Company as the legal beneficiary. Although the agreement was non-disapproved by this Department, the provision that the escrow assets be held in an escrow account "as an accounting entry on the books of Farm Bureau" is not acceptable.

It is recommended that the escrow agreement be amended to provide that escrow assets be held in a separate escrow account naming the Company as beneficiary.

It is further recommended that such escrow account be established naming the Company as beneficiary and that the escrow assets be placed in the account.

E. Abandoned Property Law

Section 1316 of the New York 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 to be 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 Abandoned Property Law.

Section 1316(3) of such law further requires that within thirty days following the filing of the report on abandoned property, insurers publish a list of any abandoned property. Section 702(4) of the New York Abandoned Property Law provides that the state Comptroller be notified of said publication.

The Company did not publicize its abandoned property requirements, and thus did not notify the Comptroller of said publication.

It is recommended that the Company comply with Section 1316(3) of the New York Abandoned Property Law and publicize a list of such abandoned property by May 1 of each year.

It is further recommended the Company comply with Section 1316(3) and Section 702(4) of the New York Abandoned Property Law by notifying the Comptroller's office of publication of this list.

Subsequent to the examination date, the Company placed a notice publicizing a list of abandoned property and duly notified the Comptroller's Office.

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 in 2004 to surplus as regards policyholders	168%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	70%
Premiums in course of collection to surplus as regards policyholders	15%

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

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

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss		
adjustment expenses incurred	\$77,379,185	67.15%
Other underwriting expenses incurred	42,119,851	36.55%
Net underwriting loss	<u>(4,263,799)</u>	<u>(3.70)%</u>
Premiums earned	<u>\$115,235,237</u>	<u>100.00%</u>

G. Accounts and Records

A review of the Company's accounts, records and annual statement reporting revealed the following:

1. Custodian Agreement

It was noted that Management answered affirmatively to the following general interrogatory in its December 31, 2004 filed annual statement:

“Excluding items in Schedule E, real estate, mortgage loans and investments held physically in the reporting entity's offices, vaults or safety deposit boxes, were all stocks, bonds and other securities, owned throughout the current year held pursuant to a custodial agreement with a qualified bank or trust company in accordance with Part – 1 General, Section IV.H – Custodial or Safekeeping Agreements of the NAIC Financial Condition Examiners Handbook?”

A review of the Company's custodial agreement with Northern Trust Company revealed that it did not contain all of the protective covenants and provisions pursuant to the guidelines per the NAIC Financial Condition Examiners Handbook. Subsequent to the date of this examination, on September 16, 2005, the Company's custodial agreement with Northern Trust Company was amended to include the protective covenant and provisions pursuant to the guidelines per the NAIC Financial Condition Examiners Handbook.

It is recommended that the Company correctly respond to all general interrogatory questions in the annual statement.

## 2. Contract with Deloitte and Touche, LLP

The Company retained Deloitte and Touche, LLP as its independent certified public accountant for the years 2002, 2003 and 2004. The review of the Company's contract with Deloitte and Touche, LLP revealed that the contract does not comply with the requirements specified in Section 89.2 of Department Regulation 118 and with Section 243.2 of Department Regulation 152.

Section 89.2 of Department Regulation 118 states, in part, that:

“...such contract must specify that:

- a) on or before May 31<sup>st</sup>, the CPA shall provide an audited financial statement of such insurer and of and subsidiary required by section 307(b)(1) of the Insurance Law together with an opinion of the financial statements of such insurer and any such subsidiary for the prior calendar year and an evaluation of the insurer's and any such subsidiary's accounting procedure and internal control systems as are necessary to the furnishing of an opinion;
- b) any determination by the CPA that the insurer has materially misstated its financial condition as reported to the superintendent or that the insurer does not meet minimum capital or surplus to policyholder requirements set forth in the Insurance Law shall be given by the CPA, in writing, to the superintendent within 15 calendar days following such determination; and
- c) the workpapers and any communications between the CPA and the insurer relating to the audit of the insurer shall be made available for review by the superintendent at the offices of the insurer, at the Insurance Department or at any other reasonable place designated by the superintendent. The CPA must retain for review such workpapers and communications in accordance with the provisions of Part 243 of this Title (Regulation 152). More specifically, such workpapers and communications must be retained by the CPA for the period specified in sections 243.2(b)(7) and (c) of this Title...”

The Company's contract with Deloitte and Touche, LLP failed to include the above-quoted requirements.

It is recommended that the Company revise its contract with its independent certified public accountant to include such wording as required by Part 89.2 of Department Regulation No. 118.

It is also recommended that the Company ensure that all future contracts entered into with its independent certified public accountants comply with Department Regulation 118.

### 3. Allocation of Expenses

The Company allocated each expense category in Part 3 – Expenses of the Underwriting and Investment Exhibit, lines 8 through 18 and write-ins, on the basis of employee salaries during the last three years of the examination. The percentages used by the Company did not change in those years. The Company could not show detailed worksheets to support how the employees' salaries were allocated among the groups in 2003 and 2004.

Part 109 of Department Regulation 30 sets forth rules and methods governing the allocation of expenses among the major expense groups. This regulation also requires insurers to maintain detailed worksheets on file, supporting percentages used in allocating expenses to the various expense groups.

It is recommended that management establish and maintain written documentation supporting the allocation of each expense category to the major expense groups as required by Part 109 of Department Regulation 30.

It is further recommended that the Company allocate its expense to each expense category in accordance with Part 109 of Department Regulation 30.

### 4. Compliance with SSAP No. 6

The Company utilized the billing date, in some cases, to calculate the non-admitted portion of uncollected premium balances.

SSAP No. 6 states, in part:

“that the due date for original and deposit premiums should be governed by the effective date of the underlying contract”.

It is recommended that the Company comply with SSAP No. 6, paragraph 7(a) by using the effective date for calculating the non-admitted portion of uncollected premiums and agents' balances in the course of collection for all original and deposit premiums.

Due to the immateriality of the difference noted as a result of using billing date versus effective date, no examination change has been made in the financial statements presented herein for this item.

### 3. FINANCIAL STATEMENTS

#### A 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>Examination</u>		<u>Company</u>	<u>Surplus</u>
		<u>Non-admitted Assets</u>	<u>Net Admitted Assets</u>	<u>Net Admitted Assets</u>	<u>Increase (Decrease)</u>
Bonds	\$39,734,389	\$ 0	\$39,734,389	\$39,734,389	\$ 0
Common stocks	1,929,329	0	1,929,329	1,929,329	0
Cash, cash equivalents and short-term investments	6,078,056	0	6,078,056	6,078,056	0
Investment income due and accrued	520,286	0	520,286	520,286	0
Uncollected premiums and agents' balances in the course of collection	3,055,504	123,224	2,932,280	2,932,280	0
Deferred premiums, agents' balances and installments booked but deferred and not yet due	8,427,220	3,521,332	4,905,888	8,427,220	(3,521,332)
Amounts recoverable from reinsurers	673,159	0	673,159	673,159	0
Net deferred tax asset	2,219,790	553,245	1,666,545	1,666,545	0
Electronic data processing equipment and software	1,132,792	1,132,792	0	0	0
Aggregate write-ins for other than invested assets	<u>76,555</u>	<u>15,409</u>	<u>61,146</u>	<u>61,146</u>	<u>0</u>
Total assets	<u>\$63,847,080</u>	<u>\$5,346,002</u>	<u>\$58,501,078</u>	<u>\$62,022,410</u>	<u>\$(3,521,332)</u>

<u>Liabilities, Surplus and Other Funds</u>	<u>Examination</u>	<u>Company</u>	Surplus Increase (Decrease)
Losses	\$13,242,460	\$13,242,460	\$0
Loss adjustment expenses	1,829,566	1,829,566	0
Commissions payable, contingent commissions and other similar charges	530,001	530,001	0
Other expenses (excluding taxes, licenses and fees)	328,799	328,799	0
Taxes, licenses and fees (excluding federal and foreign income taxes)	771,045	771,045	0
Current federal and foreign income taxes	1,027,594	1,027,594	0
Unearned premiums	17,924,771	17,924,771	0
Advance premiums	464,576	3,985,908	3,521,332
Ceded reinsurance premiums payable (net of ceding commissions)	1,020,494	1,020,494	0
Funds held by company under reinsurance treaties	68,591	68,591	0
Amounts withheld or retained by company for account of others	94,910	94,910	0
Remittances and items not allocated	10,632	10,632	0
Provision for reinsurance	2,732	2,732	0
Drafts outstanding	966,966	966,966	0
Payable to parent, subsidiaries and affiliates	484,735	484,735	0
Aggregate write-ins for liabilities	<u>(8,632)</u>	<u>(8,632)</u>	<u>0</u>
Total liabilities	<u>\$38,759,240</u>	<u>42,280,572</u>	<u>\$3,521,332</u>
<u>Surplus and Other Accounts</u>			
Common capital stock	\$5,300,000	\$5,300,000	\$0
Gross paid in and contributed surplus	28,166,983	28,166,983	0
Unassigned funds (surplus)	(13,725,145)	(13,725,145)	0
Surplus as regards policyholders	<u>\$19,741,838</u>	<u>\$19,741,838</u>	<u>\$0</u>
Totals liabilities, surplus and other funds	<u>\$58,501,078</u>	<u>\$62,022,410</u>	

Note: The Internal Revenue Service has completed its audits of the Company's consolidated federal income tax returns through tax year ending June 30, 2001. All material adjustments, if any, made subsequent to the date of examination and arising from said audits, are reflected in the financial statements included in this report. There are no audits currently under examination. The Internal Revenue Service has not yet begun to audit tax returns covering tax period July 1, 2001 through December 31, 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 \$6,539,215 during the four-year examination period January 1, 2001 through December 31, 2004, detailed as follows:

<u>Underwriting Income</u>		
Premiums earned		\$115,235,237
Deductions:		
Losses incurred	\$65,565,644	
Loss adjustment expenses incurred	11,813,541	
Other underwriting expenses incurred	<u>42,119,851</u>	
Total underwriting deductions		<u>119,499,036</u>
Net underwriting gain or (loss)		\$(4,263,799)
<u>Investment Income</u>		
Net investment income earned	\$ 8,497,207	
Net realized capital gains	<u>(34,394)</u>	
Net investment gain or (loss)		8,462,813
<u>Other Income</u>		
Net gain or (loss) from agents' or premium balances charged off	\$ (586,052)	
Finance and service charges not included in premiums	954,797	
Aggregate write-ins for miscellaneous income	<u>929,673</u>	
Total other income		<u>1,298,418</u>
Net income before dividends to policyholders and before federal and foreign income taxes		\$5,497,432
Federal and foreign income taxes incurred		<u>1,861,541</u>
Net income		<u>\$3,635,891</u>

Capital and Surplus Account

Surplus as regards policyholders per report on examination as of December 31, 2000			\$13,202,623
	<u>Gains in</u>	<u>Losses in</u>	
	<u>Surplus</u>	<u>Surplus</u>	
Net income	\$3,635,891		
Net unrealized capital gains or (losses)		\$24,592	
Change in net deferred income tax	2,184,306		
Change in non-admitted assets		5,187,373	
Change in provision for reinsurance		2,732	
Cumulative effect of changes in accounting principles		44,000	
Surplus adjustments paid in	271,901		
Contributed fixed assets	2,184,482		
Change in advance premiums	<u>3,521,332</u>	_____	
Total gains and losses	<u>\$11,797,912</u>	<u>\$5,258,697</u>	
Net increase (decrease) in surplus			<u>\$6,539,215</u>
Surplus as regards policyholders per report on examination as of December 31, 2004			<u>\$19,741,838</u>

**4. DEFERRED PREMIUMS, AGENTS' BALANCES AND INSTALLMENTS BOOKED BUT DEFERRED AND NOT YET DUE**

The examination admitted asset of \$4,905,888 is \$3,521,332 less than the \$8,427,220 reported by the Company as of December 31, 2004.

The examination change represents the disallowance of amounts billed but unpaid for policies with effective dates after December 31, 2004. SSAP No. 53, paragraph 13 states in part:

“Advance premiums result when policies have been processed, and the premium has been paid prior to the effective date. These advance premiums are reported as a liability in the statutory financial statement and not considered income until due...”

According to the Interpretation of the Emerging Accounting Issues Working Group (INT02-02),

“...a premium billing in advance of the effective date does not meet the third requirement of SSAP No. 4, paragraph 2 regarding the occurrence of the transaction or event giving rise to the entity’s right to or control of the benefit. Therefore, an asset/receivable should not be recognized on the financial statements until the effective date of the underlying policy/contract (i.e. the effective date of the contract gives rise to the entity’s right.). The mailing of a premium billing has no determination in reporting of such premiums as an asset”.

It is recommended that the Company comply with SSAP No. 53, paragraph 13 and recognize advance premiums only when the premium has been paid prior to the effective date of the contract.

It is further recommended that the Company comply with SSAP No. 4 and recognize deferred premiums, agents’ balances and installments booked but deferred and not yet due only after the policy effective date of the underlying policy/contract.

An offsetting examination change has been made to the liability “Advance premiums”; therefore, there is no net surplus effect for this examination change.

## **5. LOSSES AND LOSS ADJUSTMENT EXPENSES**

The examination liability for the captioned items of \$15,072,026 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 Company’s internal records and in its filed annual statements.

## **6. ADVANCE PREMIUMS**

The examination liability for the captioned account of \$464,576 is \$3,521,332 less than the \$3,985,908 liability reported by the Company as of the examination date. The examination change represents the disallowance of amounts billed for policies with effective dates after December 31, 2004 as more fully explained in Item 4 of this report. As noted in Item 4 of this report, advance premiums result only when the policy has been processed and the premium has been paid prior to the effective date of the policy.

## 7. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business practices 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

No problem areas were encountered.

## 8. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A     <u>Reinsurance</u></p> <p>It was recommended that the Company properly report its authorized and unauthorized reinsurers in future financial statements submitted to this department.</p> <p>The Company has complied with this recommendation.</p>	<p>7</p>
<p>B     <u>Annual Statement</u></p> <p>It was recommended that the Company record the call information for its bond holdings in future annual statements submitted to this Department.</p> <p>The Company has complied with this recommendation.</p> <p>It was recommended that the Company consider the impact of assumed reinsurance when determining the reserve for unearned premiums in future annual statements submitted to this Department.</p> <p>The Company has complied with this recommendation.</p>	<p>12</p> <p>12</p>
<p>C     It was recommended that the Company establish a procedure for tracking its complaints that will be in compliance with Circular Letter No. 11 of 1978.</p> <p>The Company has complied with this recommendation.</p>	<p>17</p>

## **9. SUMMARY OF COMMENTS AND RECOMMENDATIONS**

<u>ITEM</u>	<u>PAGE NO.</u>
A	<u>Reinsurance</u>
i.	It is recommended that in the future the Company ensure that all ceded reinsurance agreements containing broad rights to offset include the language required by this Department. <span style="float: right;">8</span>
ii.	It is recommended that in the future the Company comply with the requirements of SSAP 62, paragraph 8(c) and ensure that all ceded reinsurance contracts to which it is a party include an entire contract clause. <span style="float: right;">9</span>
B	<u>Holding Company System</u>
	It is recommended that the Company file its annual holding company registration statements in a timely manner pursuant to the provisions of Part 80-1.4 of Department Regulation 52. <span style="float: right;">10</span>
	It is recommended that the escrow agreement be amended to provide that escrow assets be held in a separate escrow account naming the Company as beneficiary. <span style="float: right;">12</span>
	It is further recommended that such escrow account be established naming the Company as beneficiary and that the escrow assets be placed in the account. <span style="float: right;">12</span>
C	<u>Abandoned Property Law</u>
	It is recommended that the Company comply with Section 1316(3) of the New York Abandoned Property Law and publicize a list of such abandoned property by May 1 of each year. <span style="float: right;">13</span>
	It is further recommended the Company comply with Section 1316(3) and Section 702(4) of the New York Abandoned Property Law by notifying the Comptroller's office of publication of this list. <span style="float: right;">13</span>
	Subsequent to the examination date, the Company placed a notice publicizing a list of abandoned property and duly notified the Comptroller's Office.
D	<u>Accounts and Records</u>
1.	<u>Custodian Agreement</u>
	It is recommended that the Company correctly respond to all general interrogatory questions in the annual statement. <span style="float: right;">14</span>

ITEMPAGE NO.

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|----|--|----|
| 2. | <u>Contract with Deloitte and Touche, LLP</u>  |    |
|    | It is recommended that the Company revise its contract with its independent certified public accountant to include such wording as required by Part 89.2 of Department Regulation No. 118.   | 15 |
|    | It is also recommended that the Company ensure that all future contracts entered into with its independent certified public accountants complies with Department Regulation 118.   | 15 |
| 3. | <u>Allocation of Expenses</u>  |    |
|    | It is recommended that management establish and maintain written documentation supporting the allocation of each expense category to the major expense groups as required by Part 109 of Department Regulation 30.   | 16 |
|    | It is further recommended that the Company allocate its expenses to each expense category in accordance with Part 109 of Department Regulation 30.   | 16 |
| 4. | <u>Compliance with SSAP No. 6</u>  |    |
|    | It is recommended that the Company comply with SSAP No. 6, paragraph 7(a) by using the effective date for calculating the non-admitted portion of uncollected premiums and agents' balances in the course of collection for all original and deposit premiums. | 16 |
| E. | <u>Deferred Premiums, Agents' Balances and Installments Booked but Deferred and Not Yet Due</u>  |    |
|    | It is recommended that the Company comply with SSAP No. 53, paragraph 13 and recognize advance premiums only when the premium has been paid prior to the effective date of the contract.   | 21 |
|    | It is further recommended that the Company comply with SSAP No. 4 and recognize deferred premiums, agents' balances and installments booked but deferred and not yet due only after the policy effective date of the underlying policy/contract.               | 21 |



*Appointment No 22353*

*STATE OF NEW YORK  
INSURANCE DEPARTMENT*

*I, HOWARD MILLS, Acting Superintendent of Insurance of the State of New York,  
pursuant to the provisions of the Insurance Law, do hereby appoint:*

**Sheik Mohamed**

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

**COUNTRYWAY 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 New York,*

*this 1st day of April, 2005*



*Howard Mills*

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**HOWARD MILLS**  
*Acting Superintendent of Insurance*