

REPORT ON EXAMINATION

OF THE

ERIE AND NIAGARA INSURANCE ASSOCIATION

AS OF

DECEMBER 31, 2008

DATE OF REPORT

MARCH 31, 2010

EXAMINER

WAYNE LONGMORE

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

March 31, 2010

Honorable James J. Wrynn  
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 30366 dated August 3, 2009 attached hereto, I have made an examination into the condition and affairs of Erie and Niagara Insurance Association as of December 31, 2008, and submit the following report thereon.

Wherever the designation “the Company” appears herein without qualification, it should be understood to indicate Erie and Niagara Insurance Association.

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 8800 Sheridan Drive, Williamsville, New York 14221.

## **1. SCOPE OF EXAMINATION**

The Department has performed a single-state examination of Erie and Niagara Insurance Association. The previous examination was conducted as of December 31, 2003. This examination covered the five-year period from January 1, 2004 through December 31, 2008. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”), which requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. This examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process. The examiners also relied upon audit work performed by the Company’s independent public accountants when appropriate.

This examination report includes a summary of significant findings for the following items as called for in the Financial Condition Examiners Handbook of the NAIC:

- Significant subsequent events
- Company history
- Corporate records
- Management and control
- Fidelity bonds and other insurance
- Territory and plan of operation
- Growth of Company
- Loss experience
- Reinsurance
- Accounts and records
- Financial statements
- Summary of recommendations

This examination report also includes a summary of significant findings regarding 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 that involve departures from laws, regulations or rules, or that are deemed to require explanation or description.

## 2. DESCRIPTION OF COMPANY

The Company was organized on January 1, 1875, as the Erie and Niagara Farmers' Insurance Association. On June 7, 1887, the Company was incorporated for the purpose of transacting business as an assessment co-operative fire insurance company in Erie and Niagara counties of New York State.

In 1958, a merger was effected with the Ashford Mutual Fire Insurance Company of Delevan, New York. Erie and Niagara Farmers' Insurance Association was the surviving corporation.

The Company's name was changed by authorization of this Department on April 18, 1961, to the Erie and Niagara Insurance Association.

On November 1, 1982, a merger was effected with the Amherst and Clarence Insurance Company, of Williamsville, New York. On January 1, 1983, a merger was effected with the Cattaraugus and Allegany County Patron's Fire Relief Association, of Randolph, New York. In both instances, the Erie and Niagara Insurance Association was the surviving corporation.

### 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 meets at least four times during each calendar year, thereby complying with Section 6624(b) of the New York Insurance Law. At December 31, 2008, the board of directors was comprised of the following eleven members:

Name and ResidencePrincipal Business Affiliation

Leonard Joseph Almquist  
Buffalo, NY

Certified Public Accountant

Gordon Paul Assad  
East Aurora, NY

President/Chief Executive Officer,  
Erie and Niagara Insurance Association  
Chairman of the Board and President/Chief  
Executive Officer,  
Cherry Valley Cooperative Insurance Company  
Director and President/Chief Executive Officer,  
E&N Financial Services, Inc.

James Walter Fulmer  
Le Roy, NY

Vice Chairman,  
Tompkins Financial Corporation  
Director,  
Cherry Valley Cooperative Insurance Company

Robert Milton Hoover  
Orchard Park, NY

Principal,  
Hoover HIT Consulting, LLC

Robert Harmon Lowe  
Geneseo, NY

Vice President/ Secretary,  
Erie and Niagara Insurance Association  
Director and Vice President/Secretary,  
Cherry Valley Cooperative Insurance Company  
Director and Vice President/Secretary,  
E&N Financial Services, Inc.

Maureen Jill Marshall  
Elba, NY

Owner/Vice President,  
Torrey Farms, Inc.

Russell Glenn Miller  
Arcade, NY

Owner,  
Plato Brook Farms

John Alan Noble  
Pavilion, NY

Chairman of the Board,  
Erie and Niagara Insurance Association  
President,  
Noblehurst Farms  
Director,  
Cherry Valley Cooperative Insurance Company

Erik Mo O'Neill  
Williamsville, NY

Senior Vice President,  
Wells Fargo Advisors LLC

Linwood Dean Poelma  
East Amherst, NY

Vice President,  
M&T Bank  
Director,  
Cherry Valley Cooperative Insurance Company

Name and ResidencePrincipal Business Affiliation

Mary Beth Powell  
Clarence, NY

President,  
Casilio Companies

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 of December 31, 2008, the principal officers of the Company were as follows:

NameTitle

John Alan Noble  
Gordon Paul Assad  
Robert Harmon Lowe  
Norman John Orlowski, Jr.

Chairman of the Board  
President/Chief Executive Officer  
Vice President/ Secretary  
Vice President/ Treasurer

Conflict of Interest Statements

The Company has in place a procedure to have its board of directors and officers complete conflict of interest questionnaires annually. Based upon the review of signed conflict of interest statements for the period under examination, 2004 through 2008, it was noted that certain conflicts were not being disclosed and in some instances the statements were not fully completed.

It is recommended that the Company exercise due care in obtaining, verifying for accuracy and completeness, and maintaining signed conflict of interest questionnaires from its board of directors, officers and key employees.

B. Territory and Plan of Operation

As of December 31, 2008, the Company was licensed to write business in New York State only, excluding the counties of Bronx, Kings, New York, Queens and Richmond.

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>
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability (excluding workers' compensation)
19	Motor vehicle and aircraft physical damage (excluding aircraft physical damage)
20	Marine and inland marine (inland marine only)

Paragraphs 5, 6, 7, 8, 9, 13, 14 and 15 can be written solely in conjunction with fire insurance written under the same policy and covering the same premises. The Company was also licensed as of December 31, 2008, to accept and cede reinsurance as provided in Section 6606 of the New York Insurance Law.

Based on the lines of business for which the Company is licensed and pursuant to the requirements of Articles 13 and 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, 2008, the Company wrote insurance through approximately 250 independent agents. The Company's predominant lines of business are commercial multiple peril, homeowners multiple peril and farmowners multiple peril, which accounted for 33.3%, 25.5% and 21.0%, respectively, of the Company's 2008 direct written business.

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 Premium Written</u>
2004	\$44,324,552
2005	\$46,227,498
2006	\$48,202,501
2007	\$49,520,512
2008	\$50,599,409

C. Reinsurance

Assumed

The Company reported no reinsurance assumed during the examination period.

Ceded

The Company ceded to authorized reinsurers only during the period under examination.

Since the date of the prior examination, December 31, 2003, the Company's net retention increased from \$160,000 to \$275,000 on property business and on casualty business the Company's net retention increased from \$175,000 to \$300,000.

All significant 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.

The Company had the following reinsurance in effect at December 31, 2008:

<u>Type of Contract</u>	<u>Cession</u>
Property 3 layers	\$1,725,000 in excess of \$275,000 each risk, each loss. The second and third layers have a maximum reinsurer liability limit for all risks involved in one occurrence as follows: Second--\$600,000 and Third--\$4,500,000. It is noted that the first layer is placed with an affiliate. See section 2(D) of the report for additional information.
Casualty 2 layers	\$700,000 in excess of \$300,000 each occurrence.  The second and third layers of the property coverage and the two layers of the casualty coverage noted above are subject to an NBCR Terrorist Activity Aggregate Limit for all loss, cost or expense caused directly or indirectly by NBCR Terrorist Activity as follows: Second Property & First Casualty--\$600,000 and Third Property and Second Casualty--\$4,500,000 ultimate net loss in the aggregate for all occurrences each agreement year.
Combined Property and Casualty Occurrence	In the event the property and casualty business covered under the second property layer and the first casualty layer noted above are both involved in the same loss, the Company retains only the first \$300,000 of the

Type of ContractCession

combined ultimate net loss in respect of both classes, provided that as respects property business, only one risk may be combined in the same occurrence. Such loss and the Company's retention thereon shall be apportioned to each class in the same proportion that the Company's ultimate net loss for each class bears to the Company's combined ultimate net loss from both classes. The reinsurer shall reimburse the Company for the difference between the Company's first \$300,000 of ultimate net loss under each class and the Company's pro rated retention on each class.

## Casualty Clash

\$1,500,000 in excess of \$1,000,000 each occurrence. The reinsurer's liability for ultimate net loss from casualty business is further limited to the following: NBCR Terrorist Activity Annual Aggregate Limit for all loss, cost or expense caused directly or indirectly by NBCR Terrorist Activity: \$1,500,000 ultimate net loss in the aggregate for all occurrences each agreement year.

As of December 31, 2008, the Company also maintained property catastrophe excess of loss coverage on a per occurrence basis:

Type of ContractCession

For the perils of windstorm, tornado and cyclone

100% in excess of \$1,500,000.

For all other perils covered under the agreement

\$11,500,000 in excess of \$1,500,000.

At December 31, 2008 the Company had a 100% quota share reinsurance treaty for equipment breakdown coverage up to a limit of \$25,000,000 on any one risk.

As of the examination date, the Company also had a property facultative facility available on an offer and acceptance basis.

Examination review of the Schedule F data reported by the Company in its filed annual statement found it to accurately reflect its reinsurance transactions in all material respects.

Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in the NAIC Accounting Practices and Procedures Manual, Statements of Statutory Accounting Principles (“SSAP”) No. 62. Representations were supported by an attestation from the Company's Chief Executive Officer and Chief Financial Officer pursuant to the NAIC Annual Statement Instructions. 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 paragraphs 26 and 27 of SSAP No. 62 as of December 31, 2008.

D. Holding Company System

Cherry Valley Cooperative Insurance Company (“Cherry Valley”)

As of December 31, 2008, the Company was affiliated with the Cherry Valley Cooperative Insurance Company, by virtue of common officers, directors and management.

The two insurers entered into a service agreement, effective July 2, 1990, whereby the Company provides specified services to Cherry Valley.

The agreement further provides that expenses incurred and paid for by the Company, in the course of providing services under this agreement, are to be allocated between the two companies in a manner consistent with Department Regulation 30. This Department issued a letter of non-objection relative to the implementation of the agreement on August 23, 1990.

During the course of the current examination, the Company entered into a new service agreement with Cherry Valley as of January 1, 2010, that contained only minor changes from the previous agreement. The new service agreement was non-objected to by the Department in a letter dated January 27, 2010.

The Company ceded business during the examination period to its affiliate, the Cherry Valley Cooperative Insurance Company. As of December 31, 2008, the property excess of loss contract provided for the assumption, on the part of Cherry Valley from Erie and Niagara, of \$25,000 in excess of \$275,000 each risk, each loss.

E & N Financial Services, Inc. ("E & N Financial")

On May 5, 1995, this Department issued a non-exception letter to the organization of a wholly owned subsidiary of the Company called E & N Financial Services, Inc. The purpose of E & N Financial is to act as an insurance agency and service subsidiary for the Company. The subsidiary is licensed by other insurance companies that offer insurance products not otherwise available from the Company.

Initially the Company purchased 100 shares of E & N Financial \$.01 par common stock, at \$60 per share, for a total investment of \$6,000. On November 3, 1997, this Department issued a non-objection letter relative to the Company purchasing another 400 shares of E & N Financial at \$60 per share, for a total of \$24,000. The Company's total investment in E & N Financial as of December 31, 2008 was \$30,000.

E & N Financial is sited at the Company's home office. An agreement was entered into between the Company and the subsidiary on January 1, 1996, whereby the Company provides specified management and operational services to E & N Financial. The agreement also provides for operating expenses incurred and paid for by the Company in the course of providing services under this agreement, to be allocated between the two companies in a manner consistent with Department Regulation 30.

Tax Allocation Agreement

The Company also has a tax allocation agreement in place with E & N Financial dated June 17, 2004. Pursuant to the terms of the agreement, the parties expect to file consolidated federal income tax returns. The agreement states in part that the consolidated tax liability will be allocated in the ratio that each member's separate taxable income bears to the sum of the separate taxable income of all members having taxable income for the year. Consistent with the requirements of Department Circular Letter No. 33 (1979), the executed tax allocation agreement was submitted to the Department. The Department found the agreement to be unobjectionable per its letter dated June 21, 2004.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2008, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	79%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	44%
Premiums in course of collection to surplus as regards policyholders	2%

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 five -year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$106,006,963	49.85%
Other underwriting expenses incurred	89,335,319	42.00
Net underwriting gain	<u>17,326,408</u>	<u>8.15</u>
Premiums earned	<u>\$212,668,690</u>	<u>100.00%</u>

F. Real Estate: Arrangement with Industrial Development Agency

On January 20, 1993, this Department granted approval for the Company to purchase a parcel of land at a cost of \$275,000, for use as a building site for a new home office. On March 2, 1993, the Department approved the Company spending \$1,801,106 to construct a new home office building. The March 2, 1993 Department approval letter noted that the building construction was being accomplished through the auspices of the Clarence Industrial Development Agency and that the Company had entered into a sale/leaseback arrangement with that Agency. Such arrangement is intended to provide tax benefits to the Company. The Company funded the land purchase and the building construction.

### March 1, 1993 Lease Agreement

The Company and the Town of Clarence, Erie County, Industrial Development Agency (“IDA”) entered into a lease agreement dated as of March 1, 1993. The term of the lease is March 1, 1993 to December 31, 2004, or such earlier date as the lease agreement may be terminated as provided in such agreement.

On March 26, 1993, the Company executed a deed in favor of the IDA, granting it title to 4.31 acres of the Company’s home office property.

The lease agreement provides that upon expiration, or sooner termination, of the lease the IDA will reconvey said leased premises and property to the Company, by quit claim deed, for a purchase price of \$1.00 and any other amounts then due under the lease agreement. The Company is obligated to make payments in lieu of taxes to the Town of Clarence, the Clarence Central School District and the County of Erie during the term of the lease.

### March 1, 2004 Lease Agreement

In correspondence from the Department dated April 18, 2003, the Company was granted approval to construct an 11,000 square foot addition to its existing home office located at 8800 Sheridan Drive, Clarence, New York.

The Company entered into another lease agreement with the Town of Clarence IDA, dated March 1, 2004, meant to induce the Company to commence with the construction of the aforementioned Department approved 11,000 square foot addition.

The term of the new lease is March 1, 2004 expiring December 31, 2019 or such earlier termination as provided for in the agreement.

In connection with the new lease, on March 4, 2004, the Company executed a deed in favor of the IDA, granting it title to an additional 5.923 acres of the home office property.

By “QUIT CLAIM DEED”, dated June 1, 2005, the Company purchased title from the IDA of the original March 1, 1993 leased premises of 4.31 acres, with certain exceptions. Under the quit claim deed the Company now has ownership of 3.42 acres of home office property.

The IDA has title to approximately 6.813 acres, consisting of the 5.923 acres per deed executed March 4, 2004 in addition to the 0.89 acres exempted from the June 1, 2005 quit claim deed.

The March 1, 2004 lease agreement provides that upon expiration or termination of the lease, as provided for in the agreement, the IDA will reconvey said leased premises and property to the Company, by quit claim deed, such title as the IDA has at the inception of the agreement, for a purchase price of \$1.00 and any other amounts then due under the lease agreement.

The IDA and the Company agree that the Company shall make payments in lieu of real estate taxes as provided for in the lease agreement to the Town of Clarence, the Clarence Central School District and the County of Erie during the term of the lease.

G. Accounts and Records

i. Approval of Investments

The previous report on examination included the following recommendation:

“It is recommended that the Company comply with the requirements of Section 1411(a) of the New York Insurance Law by having all of its investments authorized or approved as indicated in such section.”

During the current review it was found that the approval of certain investments was inadvertently left out of the official minutes of the investment committee.

It was noted that the Company’s board of directors does not approve the minutes of the investment committee. Also, it is not being documented in the official board minutes that a report of the investments that were approved at the previous meeting of the committee, is being reported to the board at its next meeting as is called for by Section 1411(a) of the New York Insurance Law.

It is recommended that the Company maintain minutes demonstrating full compliance with the requirements of Section 1411(a) of the New York Insurance Law by having all of its investments authorized or approved as indicated in such section.

ii. Rent Charges

SSAP No. 40 paragraph 15 states the following:

“A reporting entity shall include in both its income and expenses an amount for rent relating to its occupancy of its own buildings. The amount recorded shall be at a rate comparable to rent received from others and/or rental rates of like property in the same area. If this is unavailable, it shall be derived from consideration of the repairs, expenses, taxes, and depreciation incurred, plus interest added at an average fair rate on the carrying value of the reporting entity’s investment in its home office building.”

The Company is noted to have charged itself an insufficient amount in rent for the years 2004 through 2007. A sufficient amount was being charged in 2008. Nonetheless, it is recommended that the Company comply with the requirements of SSAP No. 40 paragraph 15 henceforth in determining the rental charge for the occupancy of its own building.

H. Risk Management and Internal Controls

Succession Planning

The Company is noted to have in place an “Emergency Management Succession Policy” which addresses emergency situations surrounding the Company’s president. However, the Company was unable to present a formalized succession plan document which addresses the other key officers of the entity. It is recommended that the Company implement and keep updated a formal succession plan which addresses the key officers of the entity in order to help ensure the continued operation of the Company with minimal disruption if the key officers are unavailable so as to protect the best interests of the Company and its policyholders, and have same available for review upon examination.

### 3. FINANCIAL STATEMENTS

#### A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2008 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	\$ 75,477,084	\$ 0	\$ 75,477,084
Common stocks	9,006,696	0	9,006,696
Real Estate: Properties occupied by the company	2,231,289	0	2,231,289
Cash, cash equivalents and short-term investments	8,544,157	0	8,544,157
Investment income due and accrued	831,779	0	831,779
Uncollected premiums and agents' balances in the course of collection	1,293,597	147,066	1,146,531
Deferred premiums, agents' balances and installments booked but deferred and not yet due	5,981,172	0	5,981,172
Amounts recoverable from reinsurers	99,333	0	99,333
Current federal and foreign income tax recoverable and interest thereon	501,322	0	501,322
Net deferred tax asset	3,560,507	1,038,705	2,521,802
Electronic data processing equipment and software	281,993	98,482	183,511
Furniture and equipment, including health care delivery assets	284,214	284,214	0
Receivables from parent, subsidiaries and affiliates	10,654	0	10,654
Aggregate write-ins for other than invested assets	<u>998,053</u>	<u>949,080</u>	<u>48,973</u>
Total assets	<u>\$109,101,850</u>	<u>\$2,517,547</u>	<u>\$106,584,303</u>

Liabilities, Surplus and Other FundsLiabilities

Losses and loss adjustment expenses	\$ 14,632,883
Commissions payable, contingent commissions and other similar charges	3,131,102
Other expenses (excluding taxes, licenses and fees)	2,373,154
Taxes, licenses and fees (excluding federal and foreign income taxes)	47,232
Unearned premiums	26,039,821
Advance premium	1,054,053
Ceded reinsurance premiums payable (net of ceding commissions)	(30,854)
Amounts withheld or retained by company for account of others	49,475
Remittances and items not allocated	121,820
Payable for securities	<u>2,063</u>
 Total liabilities	 \$ 47,420,749

Surplus and Other Funds

Required surplus	\$ 100,000
Unassigned funds (surplus)	<u>59,063,554</u>
 Surplus as regards policyholders	 <u>59,163,554</u>
 Total liabilities, surplus and other funds	 <u>\$106,584,303</u>

NOTE: The Internal Revenue Service has completed its audits of the Company's Federal Income Tax returns for the tax years 2005 and 2006. Audits covering subsequent tax years have yet to commence. 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 \$24,309,571 during the five-year examination period January 1, 2004 through December 31, 2008, detailed as follows:

Underwriting Income

Premiums earned		\$212,668,690
Deductions:		
Losses and loss adjustment expenses incurred	\$106,006,963	
Other underwriting expenses incurred	<u>89,335,319</u>	
Total underwriting deductions		<u>195,342,282</u>
Net underwriting gain		\$ 17,326,408

Investment Income

Net investment income earned	\$ 14,908,978	
Net realized capital gains	<u>21,419</u>	
Net investment gain		14,930,397

Other Income

Net loss from agents' or premium balances charged off	\$ (518,230)	
Finance and service charges not included in premiums	3,730,967	
Aggregate write-ins for miscellaneous loss	<u>(90,257)</u>	
Total other income		<u>3,122,480</u>
Net income before federal income taxes		\$ 35,379,285
Federal income taxes incurred		<u>9,830,000</u>
Net income		\$ <u>25,549,285</u>

Surplus as regards policyholders per report on examination as of December 31, 2003			\$34,853,983
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$25,549,285	\$ 0	
Net unrealized capital losses		1,047,340	
Change in net deferred income tax	851,361		
Change in non-admitted assets	<u>0</u>	<u>1,043,735</u>	
Total gains or losses in surplus	<u>\$26,400,646</u>	<u>\$2,091,075</u>	
Net increase in surplus			<u>24,309,571</u>
Surplus as regards policyholders per report on examination as of December 31, 2008			<u>\$59,163,554</u>

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

The examination liability for the captioned items of \$14,632,883 is the same as reported by the Company as of December 31, 2008. 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.

#### **5. 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 generally more precise scope of a market conduct investigation.

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

- 1) Sales and advertising
- 2) Underwriting
- 3) Rating
- 4) Treatment of policyholders and claimants

Except as noted below, no unfair practices were encountered.

Automatic Inflation Protection (“AIP”)

Erie and Niagara Insurance Association has been providing policyholders with automatic inflation protection for various lines of business (personal and commercial) for the past ten plus years. Management was unable to provide an exact date of when they started the practice. The value of the covered property was automatically increased each year by a certain percentage. No policy form was included as part of the policy indicating that the annual automatic adjustment would be taking place. Thus, the increase in coverage was not arising from the terms of the policy itself. Therefore, the Company was changing the value assigned to the property insured during the required three-year policy period on the affected personal lines policies and no evidence was provided that it was being done with the consent of the insured. The Company failed to conditionally renew the various policies at the renewal date and inform the insureds of the coverage changes associated with the inclusion of this automatic inflation protection coverage. The premium on the policies in question could fluctuate because of the increase in the value of the property coverage. During the course of the examination the Company brought this issue to the attention of the Department. Management was directed to submit the necessary forms for approval by the Department pursuant to Section 6609(b) of the New York Insurance Law in order to allow the Company to attach the Automatic Inflation Protection endorsement form to its policies in the future.

The Company was also told to forward notices to the affected policyholders, explaining the situation and giving them the option of continuing with the AIP or opting out of the coverage within fifteen days of the letter being received. These mailings started in January of 2010 for Erie and Niagara policyholders since the necessary forms had been approved. The Company indicated that it will begin attaching the approved endorsement forms to policies renewing after April 1, 2010. The Company issued conditional renewal notices on both personal and commercial lines policies indicating the percentage increase in the coverages and noting the endorsement form to be added to the policy at renewal.

The board of directors did not specifically approve the practice of using 4% as the automatic increase for replacement cost policies and 2% as the automatic increase for certain actual cash value policies in all cases. Thus, any premium increases caused by the AIP adjustments in those cases were not approved by the board.

Section 3425(d)(1) of the New York Insurance Law states, in part, that:

“Unless the insurer, at least forty-five but not more than sixty days in advance of the end of the policy period, mails or delivers to the named insured, at the address shown in the policy, a written notice of its intention not to renew a covered policy, or to condition its renewal upon change of limits or elimination of any coverages, the named insured shall be entitled to renew the policy upon timely payment of the premium billed to the insured for the renewal...”

Section 3426(e)(1)(B) of the New York Insurance Law states, in part, that:

“A covered policy shall remain in full force and effect pursuant to the same terms, conditions and rates unless written notice is mailed or delivered by the insurer to the first-named insured, at the address shown on the policy, and to such insured's authorized agent or broker, indicating the insurer's intention... to condition its renewal upon change of limits, change in type of coverage, reduction of coverage, increased deductible or addition of exclusion, or upon increased premiums in excess of ten percent...”

Section 6615(a)(1) of the New York Insurance Law states, in part, that:

“Every assessment corporation may, if so directed by its board of directors levy an assessment upon all of its members...”

Since the increase in coverage was not arising from the terms of the policy itself and the Company failed to conditionally renew the various policies at the renewal date and inform the insureds of the coverage changes associated with the AIP coverage, the following recommendations are being made:

It is recommended that the Company comply with the requirements of Section 3425(d)(1) of the New York Insurance Law, henceforth.

It is recommended that the Company comply with the requirements of Section 3426(e)(1)(B) of the New York Insurance Law, henceforth.

It is recommended that the Company comply with Section 6615(a)(1) of the New York Insurance Law and have its rates of assessment approved by its board of directors. This is a repeat recommendation since the Company was constructively charging insureds for increased coverage caused by the Automatic Inflation Protection that had not been definitively approved by the board in all cases.

## 6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Accounts and Records</u>	
i. It was recommended that the Company comply with the requirements of Section 1411(a) of the New York Insurance Law by having all of its investments authorized or approved as indicated in such section.	12
The Company has not fully complied with this recommendation. A similar recommendation is included in this report.	
ii. It was recommended that the Company ensure that its contracts with its CPA firm covering all future audit years meet the requirements of Department Regulation 118.	12
The Company has substantively complied with this recommendation.	
B. <u>Market Conduct Activities</u>	
i. It was recommended that the Company comply with Section 3425(c)(2) of the New York Insurance Law and only allow policies that have been in effect 60 days to be canceled for one of the statutory reasons put forth in such section.	18
The Company has substantively complied with this recommendation.	
ii. It was recommended that the Company comply with Section 6615(a)(1) of the New York Insurance Law and have its rates of assessment approved by its board of directors.	19
The Company has not fully complied with this recommendation. A similar recommendation is included in this report.	
iii. It was recommended that the Company comply with the requirements of Department Regulation 64 Parts 216.4(a) and 216.11 regarding the acknowledgement of notice of claim and the dating of all communications and transactions.	19
The Company has complied with this recommendation.	

## 7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A.     <u>Management</u></p> <p>It is recommended that the Company exercise due care in obtaining, verifying for accuracy and completeness, and maintaining signed conflict of interest questionnaires from its board of directors, officers and key employees.</p>	<p>5</p>
<p>B.     <u>Accounts and Records</u></p> <p>i.     It is recommended that the Company maintain minutes demonstrating full compliance with the requirements of Section 1411(a) of the New York Insurance Law by having all of its investments authorized or approved as indicated in such section. A similar recommendation was included in the prior report.</p> <p>ii.    It is recommended that the Company comply with the requirements of SSAP No. 40 paragraph 15 henceforth in determining the rental charge for the occupancy of its own building.</p>	<p>13</p> <p>14</p>
<p>C.     <u>Risk Management and Internal Controls</u></p> <p>It is recommended that the Company implement and keep updated a formal succession plan which addresses the key officers of the entity in order to help ensure the continued operation of the Company with minimal disruption if the key officers are unavailable so as to protect the best interests of the Company and its policyholders and have same available for review upon examination.</p>	<p>14</p>
<p>D.     <u>Market Conduct Activities</u></p> <p>i.     It is recommended that the Company comply with the requirements of Section 3425(d)(1) of the New York Insurance Law, henceforth.</p> <p>ii.    It is recommended that the Company comply with the requirements of Section 3426(e)(1)(B) of the New York Insurance Law, henceforth.</p> <p>iii.   It is recommended that the Company comply with Section 6615(a)(1) of the New York Insurance Law and have its rates of assessment approved by its board of directors. A similar recommendation was included in the prior report.</p>	<p>20</p> <p>20</p> <p>20</p>

Respectfully submitted,

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Wayne Longmore  
Senior Insurance Examiner

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

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

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Wayne Longmore

Subscribed and sworn to before me

this \_\_\_\_\_ day of \_\_\_\_\_, 2011.

STATE OF NEW YORK  
INSURANCE DEPARTMENT

I, Kermitt J. Brooks Acting Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:

Wayne Longmore

as proper person to examine into the affairs of the

**Erie and Niagara Insurance Association**

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

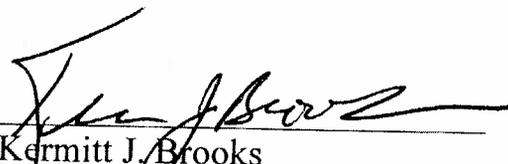
**Company**

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 3<sup>rd</sup> day of August 2009



  
Kermitt J. Brooks  
Acting Superintendent of Insurance