

REPORT ON EXAMINATION
OF THE
FRANKLIN FIRE INSURANCE COMPANY
AS OF
DECEMBER 31, 2003

DATE OF REPORT

SEPTEMBER 23, 2004

EXAMINER

NYANTAKYI AKUOKO



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

George E. Pataki
Governor

Gregory V. Serio
Superintendent

Honorable Gregory V. Serio
Superintendent of Insurance
Albany, New York 12257

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 22220 dated May 5, 2004, attached hereto, I have made an examination into the condition and affairs of the Franklin Fire Insurance Company as of December 31, 2003 and submit the following report thereon.

The examination was conducted at the Company's home office located at 733 Case Hill Road, Treadwell, New York 13846.

Wherever the designations " the Company", or "FFIC" appear herein without qualification, they should be understood to indicate the Franklin Fire Insurance Company.

TABLE OF CONTENTS

1. Scope of examination	2
2. Description of Company	2
A. Management	2
B. Territory and plan of operation	4
C. Reinsurance	5
D. Holding company system	6
E. Significant operating ratios	6
F. Abandoned property	7
G. Accounts and Records	7
3. Financial Statements	9
A. Balance sheet	9
B. Underwriting & Investment exhibit	10
4. Loss & loss adjustment expense reserve	11
5. Market conduct activities	11
6. Compliance with prior report on examination	12
7. Summary of comments and recommendations	13

1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1998. This examination covered the five-year period from January 1, 1999 through December 31, 2003 and was limited in its scope to a review or audit of only those 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. The examination included a review of income, disbursements and company records deemed necessary to accomplish such analysis or verification.

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

2. DESCRIPTION OF COMPANY

The Company was organized as the Franklin Fire Insurance Company in 1881 for the purpose of transacting business as an assessment co-operative fire insurance company in the Town of Franklin, Delaware County, New York.

As of December 31, 2003, the Company was licensed to operate in seven counties, namely, Broome, Chenango, Delaware, Greene, Otsego, Schoharie and Sullivan in New York State.

A. Management

The corporate powers of the Company, as per an amended charter and by-laws approved by the Department in 2003, is vested in a board consisting of not less than nine but not more than thirteen directors, divided into three groups as nearly equal as possible, with one group being elected at each annual policyholders' meeting for a term of three years.

As of the examination date, the board was comprised of eleven members. The board met, at least, four times in each calendar year thereby complying with Section 6624(b) of the New York Insurance Law.

Each of the director's qualification, as set forth in Article II Section I of the Company's by-laws, was reviewed and it appears that each director was duly qualified. The directors, as of December 31, 2003, were as follows:

<u>Director</u>	<u>Principal Business Affiliation</u>
Burton G. Barnes(E) Treadwell, NY	Secretary/Treasurer, FFIC
Thomas W. Barnes(E) Treadwell, NY	Vice President, FFIC & Farmer
William E. Barnes Treadwell, NY	Retired Farmer
Richard Blackman Walton, NY	Farmer
James R. Carey(E) Franklin, NY	Vice President, National Bank of Delaware County; Assistant Treasurer, FFIC
Clarence Hall(E) Treadwell, NY	School Janitor
Herman P. Herklotz(E) Franklin, NY	President, FFIC & Farmer
Owen Howarth Delhi, NY	Retired Farmer
Edward J. Sickler Franklin, NY	Owner, Sickler Memorials
Donald M. Smith Franklin, NY	Farmer
Richard Yarnes Walton, NY	Retired Farmer

(E) denotes member of Executive Committee.

The minutes of all meetings of the Board of Directors held during the examination period were reviewed. The average attendance by the board of directors was approximately 95%, with each individual director's attendance being adequate at these meetings.

The following is a list of the Company's officers, as of December 31, 2003:

<u>NAME</u>	<u>TITLE</u>
Herman P Herklotz	President
Thomas W. Barnes	Vice President
Burton G. Barnes	Secretary/Treasurer
James R. Carey	Assistant Treasurer

B. Territory and Plan of Operation

The Company writes predominantly in Delaware County, New York State through director-agents. Policies are issued for a term of three years covering farms, residential, and commercial risks, including contents, livestock, produce and machinery. Policies are issued against specified perils that include fire and windstorm. Applications for insurance are received by directors of the Company and all risks are inspected at least once every three years on or prior to the renewal dates of policies.

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

<u>Calendar Year</u>	<u>Direct Premiums Written</u>
1999	\$57,239
2000	59,970
2001	58,079
2002	56,855
2003	56,534

As of December 31, 2003, 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>Kinds of Business</u>
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass

Based upon 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.

C. Reinsurance

The Company had no assumed reinsurance premiums written as of December 31, 2003. The Schedule F as contained in the Company's annual statements filed for the years within the examination period was found to accurately reflect its reinsurance transactions. The examiner reviewed the ceded reinsurance contract on file during the examination period. The contract, as endorsed during the examination, contained the required standard clauses, including insolvency clause, meeting the requirements of Section 1308 of the New York Insurance Law.

As of December 31, 2003, the Company had the following reinsurance program in place:

Property & Casualty	Five times the Company's net retention of \$14,000, subject to a maximum cessions of \$70,000, each risk with a \$2,000 deductible on all covered perils except windstorm.
---------------------	--

The Company has not changed its net retention for its property business since the prior examination. However, the Company does share its larger risks with other New York State cooperative insurers.

D. Holding Company System

The Company was not a member of any holding company system, as of December 31, 2003.

E. Significant Operating Ratios

The following ratios have been computed, as of December 31, 2003, based upon the results of this examination:

Net premiums written in 2003 to surplus as regards policyholders	0.04 to 1
Liabilities to liquid assets	2.83%

The above ratios fall within the acceptable 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 from January 1, 1999 to December 31, 2003:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$ 82,194	34.08%
Other underwriting expenses incurred	177,056	73.41%
Net underwriting gain(loss)	<u>(18,075)</u>	<u>(7.49%)</u>
Premiums earned	<u>\$241,175</u>	<u>100.00%</u>

The Company received, for the period under examination, an exemption from the expense limitations imposed by Section 6613 of the New York Insurance Law.

F. Abandoned Property Law

The Company maintained appropriate records of unclaimed funds as required by Section 1316 of the New York Abandoned Property Law. The Company filed all required reports with the Office of the Comptroller of the State of New York, during the period under examination.

G. Accounts and Records

i. Custodial Agreement

As indicated in the National Association of Insurance Commissioners ("NAIC") Financial Condition Examiners Handbook, there are specific guidelines that should be followed in the maintenance of a custodial or safekeeping agreement. After a review of the Company's current custodial agreement, it was noted that several provisions and safeguards required by the NAIC and reinforced by the Department's Circular Letter No. 2 of 1997 were not found in the agreement. Therefore, it is recommended that the Company comply with NAIC requirements, reinforced by Circular Letter No. 2 of 1997 and obtain a custodial agreement that includes the requirements specified by the NAIC and the New York Insurance Department.

ii. Checking Account and Signature Requirement

The Company's checking account requires the signature of two officers for withdrawals. During the examination review of the cash account, it was noted that the President of the Company pre-signed some blank checks before they were completed and presented to the bank for withdrawal. This practice did not only circumvent the intent of dual control, but also violated Section 6611(a)(4)(C) of the New York Insurance Law ("NYIL"), which states in part that, "...All checks issued shall be signed either by two officers or by one officer upon the written

order of another officer..." Therefore, it is recommended that the Company comply with Section 6611(a)(4)(C) of the NYIL and implement control procedures for its checking account.

iii. Misclassification of Asset

The Company invested \$50,000 in a Certificate of Deposit with a maturity term of over one-year. The Company had classified this investment as cash. Pursuant to the NAIC Statement of Statutory Accounting Principles Manual ("SSAP") No. 26 paragraph 2, the Company should have reported this asset as a bond. SSAP No. 26 paragraph 2 states in part that, "certificates of deposit and commercial paper that have fixed schedule of payments and maturity date in excess of one year from the date of acquisition" are defined as bonds. Therefore, it is recommended that the Company comply with SSAP No. 26 paragraph 2 and report investments in certificate of deposits, with maturity term excess of one year, as bonds in Schedule D of the annual statement.

3. FINANCIAL STATEMENTS

A. Balance sheet

The following shows the Company's assets, liabilities and surplus as regards policyholders as determined by this examination and as reported by the Company, as of December 31, 2003.

<u>Assets</u>	Ledger <u>Assets</u>	Not-Admitted <u>Assets</u>	Net Admitted <u>Assets</u>
Bonds	\$ 979,918	\$-0-	\$ 979,918
Cash, cash equivalents and short term investments	<u>231,530</u>	-0-	<u>231,530</u>
Total Assets	<u>\$1,211,448</u>	<u>\$-0-</u>	<u>\$1,211,448</u>
 <u>Liabilities & Surplus</u>			
Losses and loss adjustment expenses			\$ 2,100
Taxes, licenses and fees			434
Unearned premium			<u>28,221</u>
Total liabilities			\$ 30,755
Required Surplus		\$ 100,000	
Unassigned Funds		<u>1,080,693</u>	
Surplus as regards policyholders			<u>\$ 1,180,693</u>
Total			<u>\$ 1,211,448</u>

The Internal Revenue Service did not audit the Company's federal income tax returns during the period under examination. The examiner is unaware of any potential exposure of the Company to any further tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$302,964 during the five-year examination period, January 1, 1999 through December 31, 2003. The following is a condensed statement of the underwriting and investment results:

Statement of Income

Underwriting Income

Premiums earned		\$ 241,175
Losses and loss adjustment expenses incurred	\$ 82,194	
Other underwriting expenses incurred	<u>177,056</u>	
Total underwriting deductions		<u>259,250</u>
Net underwriting gain(loss)		\$ (18,075)

Investment Income

Net investment income earned	\$ 300,280	
Net realized capital gain	<u>11,099</u>	
Net investment gain(loss)		311,379
Net income before dividends to policyholders and federal; and foreign income taxes		\$ 293,304
Less: Dividends to Policyholders		-0-
Net income before federal and foreign Income taxes		\$ 293,304
Federal and foreign income taxes incurred		<u>-0-</u>
Net income(loss)		<u>\$ 293,304</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 1998, per prior Report on examination			\$ 877,730
	<u>Gain in Surplus</u>	<u>Losses in Surplus</u>	
Net income or loss	\$ 293,304	\$-0-	
Net unrealized capital losses	9,659	-0-	
Change in non-admitted assets	<u>-0-</u>	<u>-0-</u>	
Total gains and losses	<u>\$ 302,963</u>	<u>\$-0-</u>	
Net increase in surplus			\$ 302,963
Surplus as regards policyholders per report on examination, as of December 31, 2003			\$ 1,180,693

4. LOSS AND LOSS ADJUSTMENT EXPENSE RESERVE

This examination included a review of the Company's loss register to determine the existence of any outstanding claims and any trends in the reporting of incurred but not reported losses. The Company reported liability \$2,100, which is the same as the amount reported as the examination liability.

5. MARKET CONDUCT ACTIVITIES

During 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. This examination's general review was directed at practices of the Company in the following areas:

- A. Sales and advertising
- B. Underwriting

- C. Rating
- D. Claims
- E. Cancellations
- F. Complaint procedures

Acknowledging pertinent Communications(Regulation 64)

During the review of the loss register and claims files, it was noted that the Company did not maintain records to indicate that it acknowledged receipt of claims notices within 15 working days. Neither were there any notations in the claim files to indicate that other methods of acknowledgement were employed, as required by 11 NYCRR 216.4 (Regulation 64).

Therefore, it is recommended that the Company comply with 11 NYCRR 216.4 (Regulation 64) and acknowledge receipt of claimant notices within 15 working days and maintain records of such communications in the claim files.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report contained one recommendation as follows (page numbers refer to the prior report):

<u>Item</u>	<u>Page No.</u>
A. It was recommended that the Company comply with Section 1409(a) of the New York Insurance Law and not invest more than ten percent of its admitted assets in any one institution.	8

The Company has complied with this recommendation

<u>Item</u>	<u>Page No.</u>
B. The Company was directed to comply with Section 6610(c) of the New York Insurance Law and obtain adequate information with policy applications when more than one risk is involved.	13
The Company has complied with this recommendation.	

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>Item</u>	<u>Page No.</u>
A. <u>Custodial Agreement</u>	
It is recommended that the Company comply with NAIC requirements, reinforced by Circular Letter No. 2 of 1997 and obtain a custodial agreement that includes the requirements specified by the NAIC and the New York Insurance Department.	7
B. <u>Checking Account and signature requirements</u>	
It is recommended that the Company comply with Section 6611(a)(4) (C) of the New York Insurance Law and implement control procedures for its checking account	8

<u>Item</u>	<u>Page No.</u>
C. <u>Misclassification of Asset</u>	
It is recommended that the Company comply with SSAP No. 26 paragraph 2 and report investments in certificate of deposits, with maturity term in excess of one year, as bond in Schedule D of the annual statement.	8
D. <u>Acknowledging Pertinent Communications</u>	
It is recommended that the Company comply with 11 NYCRR 216.4 and acknowledge receipt of claimant notices within 15 working days and maintain records of such communication in the claim files.	12

Appointment No 22220

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, GREGORY V. SERIO , Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:

Nyantakyi Akuoko

as proper person to examine into the affairs of the

Franklin Fire 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 5th day of May-2004



A handwritten signature in black ink, appearing to read "G. V. Serio", written over a horizontal line.

GREGORY V. SERIO
Superintendent of Insurance