REPORT ON EXAMINATION

OF THE

OTSEGO MUTUAL FIRE INSURANCE COMPANY

AS OF

DECEMBER 31, 2012

DATE OF REPORT	SEPTEMBER 26, 2013
EXAMINER	WAYNE LONGMORE

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September 26, 2013

Honorable Benjamin M. Lawsky
Superintendent of Financial Services
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 31000 dated April 29, 2013, attached hereto, I have made an examination into the condition and affairs of Otsego Mutual Fire Insurance Company as of December 31, 2012, and submit the following report thereon.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate Otsego Mutual Fire Insurance Company.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York State Department of Financial Services.

The examination was conducted at the Company's home office located at 143 Arnold Road, Burlington Flats, New York 13315-0040.

1. SCOPE OF EXAMINATION

The Department has performed an individual examination of the Company, a single-state insurer. The previous examination was conducted as of December 31, 2007. This examination covered the five-year period from January 1, 2008 through December 31, 2012. 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 Handbook:

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
Statutory deposits
Financial statements
Summary of recommendations

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

Otsego Mutual Fire Insurance Company was organized under the laws of the State of New York on February 18, 1897 and commenced business on April 1, 1897.

On December 29, 1942 the Company merged with Chemical Mutual Fire Insurance Company and Otsego Mutual Fire Insurance Company was the surviving company. On this date the corporate powers were amended to permit the Company to do business in the entire State of New York in accordance with the provisions of Section 367 of the Insurance Law of the State of New York, and wherever authorized by law, in any other State of the United States of America or the District of Columbia.

On June 12, 1943, the Company was authorized to issue non-assessable policies.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of eleven members. Every person insured by the Company is entitled to one vote in person and may vote by proxy. Two board meetings and two executive committee meetings were held each year of the examination period, thereby complying with Section 6624(b) of the New York Insurance Law.

At December 31, 2012, the board of directors was comprised of the following ten members:

Name and Residence	Principal Business Affiliation
John Arthur Blackman Edmeston, NY	Retired

Name and Residence	Principal Business Affiliation
Deanne Payne Burke New Hartford, NY	Vice President, Otsego Mutual Fire Insurance Company
Denise Julianna Clark Voorheesville, NY	Associate Vice President for Research Administration, University of Maryland, College Park, MD
Kelley Burke Cough Sauquoit, NY	President, Otsego Mutual Fire Insurance Company
Kevin Scott Cough New Hartford, NY	Claims Manager, Otsego Mutual Fire Insurance Company
Terry Michael Gras West Winfield, NY	Corporate Secretary, Otsego Mutual Fire Insurance Company
Judith Burke Hamilton Cassville, NY	Assistant Secretary/Data Processing Manager, Otsego Mutual Fire Insurance Company
Dion Alan Howard Edmeston, NY	Proprietor, Howard's Trailer Sales
Timothy Richard Johnson, Esq. Edmeston, NY	Deputy Chief Member Counsel for the National Rural Electric Cooperative Association in Arlington, VA
Francis Kearn Peo West Winfield, NY	Retired

Note: Cynthia Woody was subsequently appointed as a director March 6, 2013 to fill a vacancy and bring the number of directors up to eleven.

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended with the exception of Deanne Burke who attended less than 50% of the meetings for which she was eligible to attend during the period under examination.

Members of the board have a fiduciary responsibility and must evince an ongoing interest in the affairs of the insurer. It is essential that board members attend meetings consistently and set forth their views on relevant matters so that the board may reach appropriate decisions. Individuals who fail to attend at least one-half of the regular meetings do not fulfill such criteria. It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.

As of December 31, 2012, the principal officers of the Company were as follows:

Name	Title
Kelley Burke Cough	President
Terry Michael Gras	Secretary
Greg Michael Gaeta	Treasurer
Deanne Payne Burke	Vice President
Judith Burke Hamilton	Assistant Secretary

B. Territory and Plan of Operation

As of December 31, 2012, the Company was licensed to write business in New York only. 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:

Paragraph	Line of Business
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
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine (inland marine only)

Based on the lines of business for which the Company is licensed and pursuant to the requirements of Articles 13, 41 and 66 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of $523,141.

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

Calendar Year	Direct Written Premiums
2008	$16,689,807

2009	$16,930,218
2010	$17,258,233
2011	$17,042,441
2012	$17,034,057

The Company's predominant lines of business are Homeowners Multiple Peril and Fire, which accounted for 84% and 8%, respectively of the 2012 direct premium writings.

The Company markets its business through approximately 98 independent agents located throughout the Company's territory and over 85% of in force business at December 31, 2012 is on an agency bill basis.

C. Reinsurance

Assumed reinsurance

Assumed reinsurance accounted less than 1% of the Company's gross premium written at December 31, 2012. These assumptions represent the Company's participation in the Regional Reciprocal Catastrophe Pool. The Company utilizes reinsurance accounting as defined in Statement of Statutory Accounting Principle ("SSAP") No. 62R for all of its assumed reinsurance business.

Ceded reinsurance

The Company has structured its ceded reinsurance program as of December 31, 2012, as follows:

Type of Treaty	Cession
Property 50% Authorized or Accredited	$440,000 excess $60,000 each risk (or any one location as respects Inland Marine), each loss occurrence subject to an occurrence limit of $1,320,000. The Company shall retain net and unreinsured, in addition to the above, an annual aggregate retention equal to 2% of subject net premium as defined in the agreement each contract year.
Casualty 50% Authorized or Accredited	$440,000 excess $60,000 per occurrence.

Type of Treaty	Cession
Terrorism Property and Casualty	$1,320,000 excess $60,000 each contract year.
Basket (loss common to both property and casualty)	$60,000 excess $60,000 any one occurrence.
All lines Quota Share Property and Casualty 50% Authorized or Accredited	50% of the business covered by the agreement after deducting all other reinsurance inuring to the benefit of the agreement, subject to a maximum ultimate net loss of $60,000 each loss and a per occurrence limit of $10 Million. Terrorism coverage is limited to $5 Million in aggregate any profit period.
Facultative First Surplus Property 50% Authorized or Accredited	The Company will have a net retention of at least $5,000 (after 50% quota share) on each risk. The reinsurer will automatically be liable on a pro-rata basis subject to a maximum limit of $500,000 any one risk and $21 Million per occurrence. Terrorism coverage is limited to $7Million in aggregate any profit period.
Property Catastrophe Excess (4 layers)	
Layer 1 50% Authorized or Accredited	50% of $2 Million excess $1.5 Million ultimate net loss each loss occurrence, not to exceed $2Million with respect to all occurrences during the term of the agreement.
Layer 2 50% Authorized or Accredited	50% of $4 Million excess $3.5 Million ultimate net loss each loss occurrence, not to exceed $4Million with respect to all occurrences during the term of the agreement.
Layer 3 50% Authorized or Accredited	50% of $5 Million excess $7.5 Million ultimate net loss each loss occurrence, not to exceed $5Million with respect to all occurrences during the term of the agreement.
Layer 4 50% Authorized or Accredited	100% of $12.5 Million excess $12.5 Million ultimate net loss each loss occurrence, not to exceed $25 Million with respect to all occurrences during the term of the agreement.

It is the Company's policy to obtain the appropriate collateral for its cessions to unauthorized reinsurers. Letters of credit (“LOCs”) obtained by the Company to take credit for cessions to unauthorized reinsurers were reviewed for compliance with Department Regulation 133. During that review, it was noted in two of the LOCs reviewed that the following wording called for by Part 79.2

(i) of Regulation 133 was not stated. Part 79.2(i) Regulation 133 states in part that for a letter of credit to be acceptable, it must:

> (i) state that it is subject to and governed by the laws of the state of New York and the 1993 Revision of the Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce (Publication 500) and that, in the event of any conflict, the Laws of the state of New York will control. If the beneficiary is a foreign insurer, then such insurer's state of domicile may be substituted for New York. The letter of credit must contain a provision for an extension of time, of not less than 30 days after resumption of business, to draw against the letter of credit in the event that one or more of the occurrences described in Article 17 of Publication 500 occurs;

It is recommended that the Company review and update its letters of credit to ensure that all current and any future letters of credit are in compliance with the requirements of 11 NYCRR 79.2 (Department Regulation 133).

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.

Examination review found that the Schedule F data reported by the Company in its filed annual statement accurately reflected 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. 62R. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's President (Chief Executive Officer) and its Secretary. 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 SSAP No. 62R.

D. Holding Company System

The Company was not a member of any holding company system as of December 31, 2012.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2012, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	6%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	17%
Premiums in course of collection to surplus as regards policyholders	3%

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:

	Amounts	Ratios
Losses and loss adjustment expenses incurred	$14,432,611	65.43%
Other underwriting expenses incurred	1,448,728	6.57
Net underwriting gain	6,176,120	28.00
Premiums earned	$22,057,459	100.00%

F. Accounts and Records

i. Written Contract with independent Certified Public Accountants ("CPA")

The contract between the Company and its independent CPA firm for the annual statement audit as of December 31, 2012 was reviewed for compliance with the requirements of Department Regulation 118. Part 89.10(a) of Department Regulation 118 prescribes four provisions that the contract must specify. The review revealed that the contract did not include the following three required provisions (item numbers below refer to the paragraph numbers in the Regulation):

> (1) that the CPA is independent with respect to the company and is acting in conformity with the standards of the CPA's profession, such as contained in the Code of Professional Ethics and pronouncements of the AICPA and the Rules of Professional

> Conduct of the New York Board of Public Accountancy, or similar code and meets the definition of a CPA set forth in subdivision (g) of section 89.1 of this Part;
>
> (2) that the CPA understands the annual audited financial report, that the CPA's opinion thereon will be filed in compliance with this Part and that the superintendent will be relying on this information in the monitoring and regulation of the financial condition of the company;
>
> (4) that the CPA represents that it is in compliance with the requirements of Section 89.5 of this Part.

Additionally, Part 89.8(a) of Department Regulation 118 requires that the CPA firm notify within five business days, the superintendent, the board of directors and the Company’s audit committee of any determination by the CPA that the company has materially misstated its financial condition as reported to the superintendent as of the balance sheet date currently under audit or that the company does not meet the minimum capital or surplus requirement of the insurance law as of that date. However, it was noted that the executed contract provides notification by the CPA firm within fifteen business days.

It is recommended that the Company ensure that future agreements with its CPA are in compliance with the requirements of Department Regulation 118.

ii. Actuarial Report

Pursuant to the NAIC’s Annual Statement Instructions, every annual statement must include a Statement of Actuarial Opinion, prepared by a Qualified Actuary, setting forth his or her opinion relating to the insurer’s reported loss and loss adjustment expense reserves. The Actuarial Opinion must include assurance that an Actuarial Report and underlying actuarial workpapers supporting the Actuarial Opinion will be maintained at the Company and available for regulatory examination by May 1 of the year following the year-end for which the opinion was rendered or within two weeks after a request from an individual state commissioner. Further, the Actuarial Report must be consistent with the documentation and disclosure requirements of Actuarial Standard of Practice (“ASOP”) #41.

The Company provided the actuarial workpapers underlying the Actuarial Opinion; however, it could not provide an Actuarial Report.

It is recommended that the Company prepare an Actuarial Report underlying the Statement of Actuarial Opinion, on an annual basis, pursuant to the NAIC Annual Statement Instructions and ASOP #41.

G. Risk Management and Internal Controls

It was noted that one of the employees authorized to print checks is also responsible for preparing the checking account reconciliation. A similar observation was made during the previous examination.

It is again recommended that the Company strengthen its internal controls by segregating the functions of checking account reconciliation and check writing.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2012 as determined by this examination and as reported by the Company:

Assets	Assets	Assets Not Admitted	Net Admitted Assets
Bonds	$37,632,263	$ 0	$37,632,263
Preferred stocks (stocks)	848,000	0	848,000
Common stocks (stocks)	39,164,250	0	39,164,250
Real Estate: Properties occupied by the company	430,721	0	430,721
Cash, cash equivalents and short-term investments	6,846,672	0	6,846,672
Investment income due and accrued	443,535	0	443,535
Uncollected premiums and agents' balances in the course of collection	2,470,059	11,392	2,458,667
Deferred premiums, agents' balances and installments booked but deferred and not yet due	57,731	0	57,731
Amounts recoverable from reinsurers	1,980,080	0	1,980,080
Current federal and foreign income tax recoverable and interest thereon	766,366	0	766,366
Electronic data processing equipment and software	39,225	0	39,225
Furniture and equipment, including health care delivery assets	176,223	176,223	0
Cash value life insurance	2,508,957		2,508,957
Prepaid pensions	1,626,425	1,626,425	0
Pools and associations	134,647	5,074	129,573
Overfunded plan asset	(1,626,425)	(1,626,425)	0
Total assets	$93,498,729	$ 192,689	$93,306,040

Liabilities, Surplus and Other Funds		
Liabilities		
Losses and loss adjustment expenses		$ 4,363,336
Commissions payable, contingent commissions and other similar charges		56,118
Other expenses (excluding taxes, licenses and fees)		375,466
Taxes, licenses and fees (excluding federal and foreign income taxes)		78,957
Net deferred tax liability		3,833,850
Unearned premiums		2,790,445
Advance premium		39,703
Ceded reinsurance premiums payable (net of ceding commissions)		1,307,188
Provision for SERPS		1,297,775
Liability for plan benefits		195,339
Total liabilities		$14,338,177
Surplus and Other Funds		
Required surplus	$ 523,141	
Unassigned funds (surplus)	78,444,722	
Surplus as regards policyholders		78,967,863
Total liabilities, surplus and other funds		$93,306,040

Note: The Internal Revenue Service (IRS) has not performed any audits of the Company's federal income tax returns for the examination period. 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. Statement of Income

Surplus as regards policyholders increased $12,460,343 during the five-year examination period January 1, 2008 through December 31, 2012, detailed as follows:

Underwriting Income		
Premiums earned		$22,057,459
Deductions:		
Losses and loss adjustment expenses incurred	$14,432,611	
Other underwriting expenses incurred	1,448,728	
Total underwriting deductions		15,881,339
Net underwriting gain or (loss)		$ 6,176,120
Investment Income		
Net investment income earned	$ 9,683,595	
Net realized capital gain	251,431	
Net investment gain or (loss)		9,935,026
Other Income		
Net gain or (loss) from agents' or premium balances charged off	$ (12,886)	
Finance and service charges not included in premiums	58,514	
Aggregate write-ins for miscellaneous income	644,720	
Total other income		690,348
Net income before federal and foreign income taxes		$16,801,494
Federal and foreign income taxes incurred		3,406,760
Net Income		$13,394,734

	Gains in Surplus	Losses in Surplus	
Surplus as regards policyholders per report on examination as of December 31, 2007			$66,507,522
Net income	$13,394,737		
Net unrealized capital gains or (losses)	187,713		
Change in net deferred income tax		$ 36,315	
Change in nonadmitted assets	1,514,713		
Aggregate write-ins for gains and losses in surplus	0	2,600,505	
Total Gains & Losses in Surplus	$15,097,163	$2,636,820	
Net increase (decrease) in surplus			$12,460,343
Surplus as regards policyholders per report on examination as of December 31, 2012			$78,967,865

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of $4,363,336 is the same as reported by the Company as of December 31, 2012. 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. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

ITEM			PAGE NO.
A.		Management	
	i.	It is recommended that the Company maintain formal minutes of committee meetings, as required by Section 6611(a)(3) of the New York Insurance Law. The Company has complied with this recommendation.	5
	ii.	It is recommended that the Company adhere to all the provisions of its charter and by-laws, henceforth. The Company has complied with this recommendation.	5
B.		Reinsurance	
		It is recommended that the Company include the above referenced language from Circular Letter No. 5 (1988) in all reinsurance contracts which make reference to a novation. The Company has complied with this recommendation.	9
C.		Accounts and Records	
	i.	It is recommended that the Company strictly adhere to the requirements of Section 1409(a) of the New York Insurance Law, henceforth. The Company has complied with this recommendation.	10
	ii.	It is again recommended that the Company include wording in the minutes indicating that the Company's investment activities are being approved by the board of directors in accordance with Section 1411(a) of the New York Insurance Law. The Company has complied with this recommendation.	11
	iii.	It is recommended that the Company comply with Part 107.4(e) of Regulation 30 as regards the allocation of expenses to the expense groups and ensure that actual time studies performed are documented and that such detailed documentation is readily available for review upon examination. The Company has complied with this recommendation.	11
	iv.	It is recommended that the Company comply with Section 1217 of the New York Insurance Law, henceforth.	12

ITEM		PAGE NO.
	The Company has complied with this recommendation.	
D.	Risk management and internal controls	
i.	It is recommended that the Company seek to establish feasible limits, based on the Company's operating environment, on individual user's check printing capabilities as this is a good internal control.	12
	The Company has complied with this recommendation.	
ii.	It is recommended that the Company separate the functions of checking account reconciliation and check writing as this is a good internal control.	12
	The Company has not complied with this recommendation. A similar comment is made in this report.	
E.	Market conduct activities	
i.	It is recommended that the Company comply with Part 216.6(d) as well as Part 216.11 of Regulation 64 henceforth when it has determined that there is no coverage, thereby maintaining in a claim file all communications, transactions, notes and workpapers relating to the claim to enable Department personnel to reconstruct all events relating to a claim.	17
	The Company has complied with this recommendation.	
ii.	It is recommended that the Company comply with Part 216.6(h) of Regulation 64 and include the prescribed wording when issuing notices rejecting any element of a claim involving personal property insurance.	17
	The Company has complied with this recommendation.	
iii.	It is recommended that the Company comply with the redlining notice requirements of Part 218.5(a) of Regulation 90 when issuing agent termination letters and that it obtain and use the correct wording for said notice.	18
	The Company has complied with this recommendation.	
iv.	It is again recommended that the Company provide a specific reason for non-renewal in future non-renewal notices as required by Section 3425(d)(1) of the New York Insurance Law.	18
	The Company has complied with this recommendation.	

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM		PAGE NO.
A.	Management	
	It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.	4
B.	Reinsurance	
	It is recommended that the Company review and update its letters of credit to ensure that all current and any future letters of credit are in compliance with the requirements of 11 NYCRR 79.2 (Department Regulation 133).	8
C.	Accounts and Records	
i.	It is recommended that the Company ensure that future agreements with its CPA are in compliance with the requirements of Department Regulation 118.	10
ii.	It is recommended that the Company prepare an Actuarial Report underlying the Statement of Actuarial Opinion, on an annual basis, pursuant to the NAIC Annual Statement Instructions and ASOP #41.	11
iii.	It is again recommended that the Company strengthen its internal controls by segregating the functions of checking account reconciliation and check writing.	11

Respectfully submitted,

/s/

Wayne Longmore
Senior Insurance Examiner

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

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.

/s/

Wayne Longmore

Subscribed and sworn to before me

this__________ day of ___________________, 20xx.

APPOINTMENT NO. ___*31000*___

NEW YORK STATE

DEPARTMENT OF FINANCIAL SERVICES

*I, **BENJAMIN M. LAWSKY**, Superintendent of Financial Services of the State of New York, pursuant to the provisions of the Financial Services Law and the Insurance Law, do hereby appoint:*

Wayne Longmore

as a proper person to examine the affairs of the

Otsego Mutual Fire Insurance Company

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

COMPANY

with such other information as he shall deem requisite.

In Witness Whereof, I have hereunto subscribed by name
and affixed the official Seal of the Department
at the City of New York

this 29th day of April, 2013

BENJAMIN M. LAWSKY
Superintendent of Financial Services

By:

Jean Marie Cho
Deputy Superintendent