

REPORT ON EXAMINATION

OF THE

PUBLIC SERVICE MUTUAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2003

DATE OF REPORT

MAY 23, 2005

EXAMINER

FE ROSALES, C.F.E.

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STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 0004

May 23, 2005

Honorable Howard Mills
Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 22263 dated October 28, 2004 attached hereto, I have made an examination into the condition and affairs of Public Service Mutual Insurance Company as of December 31, 2003, and submit the following report thereon.

Wherever the designations "the Company" or "PSM" appear herein without qualification, they should be understood to indicate Public Service Mutual 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 administrative offices located at One Park Avenue, New York, NY 10016.

1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1999. This examination covered the four-year period from January 1, 2000 through December 31, 2003. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination comprised a complete verification of assets and liabilities as of December 31, 2003. The examination included a review of income, disbursements and company records deemed necessary to accomplish such analysis or verification and utilized, to the extent considered appropriate, work performed by the Company's independent public accountants. A review 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

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

The Company was incorporated in the State of New York on June 24, 1925 and received subsequent licensing authority from the State on July 20, 1925 under the initial name, Public Service Mutual Casualty Corporation, which was amended in 1940 to Public Service Mutual Casualty Company, Inc. In 1944, the Company's name was again amended to its present name Public Service Mutual Insurance Company ("PSM").

Effective June 30, 1965, the Company merged with the General Mutual Insurance Company, Albany, New York, with PSM emerging as the surviving insurer.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company shall be vested in a board of directors consisting of fifteen members. Each director shall serve on the board for a term of three years following his or her election by a majority vote of the Company's policyholders during their annual meeting.

As of December 31, 2003, there were fifteen directors as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Charles Lanham Crouch, III La Canada, CA	Attorney, Perkins Coie LLP
Andrew Lawrence Furgatch Los Angeles, CA	Chairman of the Board, Public Service Mutual Insurance Company
Julius Gantman White Plains, NY	Attorney, Tellerman, Taticoff & Greenberg
Anita Davis Goodman Hartsdale, NY	Real Estate Broker

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
John David Hatch Ocala, FL	Attorney, Insurance Horizons, Inc.
Donald Henderson Aromas, CA	Insurance Consultant
John Thomas Hill, II Pennington, NJ	President, Public Service Mutual Insurance Company
David Anthony Lawless Mamaroneck, NY	Senior Vice President, Public Service Mutual Insurance Company
Harold Norman London Malverne, NY	Certified Public Accountant, Freeman & Davis LLP
Stanley Joseph Mastrogiacomo Warwick, NY	Insurance Consultant
Milton Peckman Coconut Creek, FL	Attorney and Secretary, Public Service Mutual Insurance Company
Paul Steven Schweitzer Potomac, MD	Business Executive, Julien J. Studley, Inc.
Leslie Wilfred Seldin, D.D.S. New York, NY	Dentist
Lewis James Spellman, Ph. D. Austin, TX	Professor, University of Texas
Irwin Wallace Young Manhasset, NY	Business Executive, DuArt Film Labs, Inc.

The minutes of all meetings of the board of directors held during the examination period were reviewed. The review indicated that the meetings were generally well attended by the board members.

The Company also has executive, investment and compensation committees comprising of three board members per committee. Designated board members serve on their respective committees for one year at a time and are elected annually by majority votes of the board.

The board met regularly four times each year, usually one meeting per quarter as stipulated in the Company's by-laws. There were no separate executive committee meetings for the examination period. The Investment Committee meets four times a year to approve investment transactions for each quarter.

It is noted that the Company has no established procedure for disclosure to its board of directors of any material interest or affiliation on the part of any of its officers or responsible employees which is in or likely to conflict with the official duties of such person.

It is also noted that the Company did not respond accurately to Question No. 14 of the General Interrogatory which asks:

"Has the reporting entity an established procedure for disclosure to its board of directors of any material interest or affiliation on the part of any of its officers, directors, trustees or responsible employees which is in or likely to conflict with the official duties of such person"?

It is recommended that all officers and responsible employees complete conflict of interest questionnaires annually to disclose all possible conflicts to the board of directors.

It is also recommended that the Company respond accurately to all General Interrogatory questions of the annual statement.

As of December 31, 2003, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Andrew Furgatch	Chairman and Chief Executive Officer
John Thomas Hill II	President
Milton Peckman	Secretary
Daniel Tagliaferro	Treasurer / Vice President
David Lawless	Senior Vice President
Lonnie Cagley	Vice President – Underwriting
Louis Masucci	Vice President – Underwriting
John Lawrence Gaddy	Vice President – Claims
Theodore Smyk	Vice President – Claims

It is noted that Daniel Tagliaferro resigned from the Company effective November 2004.

B. Territory and Plan of Operation

As of December 31, 2003, the Company was licensed to write business in all fifty states and the District of Columbia.

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 incident to coverages contemplated under paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law, including coverage described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69th Congress as amended; 33 USC Section 901 et seq. as amended). The Company is also licensed to transact the kinds of insurance and reinsurance as defined in Section 4102(c) of the New York Insurance Law.

The Company is also licensed to write special risk insurance pursuant to Article 63 of the New York Insurance Law.

Based upon the lines of business for which the Company is licensed, and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, PSMIC is required to maintain a minimum surplus to policyholders in the amount of \$35,000,000.

The Company's principal lines of business are commercial multiple peril, workers' compensation, private passenger auto liability, automobile physical damage, other liability occurrence, and homeowners. Commercial multiple peril and workers' compensation account for approximately 87% of net written premiums. The Company specializes in commercial package policies and workers' compensation for restaurants, mercantile establishments, habitational risks, and light manufacturing risks. Business is produced through independent agents and brokers.

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

DIRECT PREMIUMS WRITTEN

<u>Calendar Year</u>	<u>New York State</u>	<u>Total United States</u>	Premiums Written in New York State as a <u>Percentage of United States</u> <u>Premiums</u>
2000	\$40,819,869	\$127,614,188	31.99%
2001	\$41,275,523	\$140,175,636	29.45%
2002	\$36,152,760	\$132,054,494	27.38%
2003	\$42,129,000	\$147,836,186	28.50%

The majority of the Company's direct written premiums during the examination period occurred in the States of California, Massachusetts, New Jersey and New York.

C. Reinsurance

Assumed

In 2003, the Company's assumed premiums represented approximately 21% of its total book of business for the year. This assumption stemmed from the Company's participation in an inter-company pooling arrangement with its wholly-owned subsidiary, Paramount Insurance Company ("Paramount"), a New York domiciled property and casualty company. Under the agreement, the Company assumes 100% of Paramount's net direct business and cedes 10% of the combined net business to Paramount, excluding voluntary assumed reinsurance.

The Company also assumes business under a 90% quota share reinsurance agreement with another wholly-owned subsidiary, Western Select Insurance Company ("WSI").

Ceded

The Schedule F data as contained in the Company's filed annual statement was found to accurately reflect its reinsurance transactions.

The examiner reviewed all ceded reinsurance contracts in effect at December 31, 2003. The contracts all contained the required standard clauses including insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

The Company has the following reinsurance program as of December 31, 2003:

TreatyProperty

First Surplus
90% Authorized

Per Risk Excess of Loss
(2 layers)
68.5% Authorized

Catastrophe Excess of Loss
(6 layers)
67% Authorized

Casualty

Excess of Loss
(2 layers)
100% Authorized

Clash
90% Authorized

Workers' Compensation
Catastrophe Excess of Loss
100% Authorized

Cession

Up to five times the minimum net retention of \$250,000 per risk subject to a maximum cession of \$10,000,000 per risk. Maximum occurrence limit of \$24,000,000.

\$9,700,000 excess of \$300,000 each and every risk. Maximum any one occurrence limit of \$19,400,000.

95% of \$97,000,000 excess of \$3,000,000 ultimate net loss each and every loss occurrence.

75% of \$10,350,000 ultimate net loss excess of \$650,000 ultimate net loss each loss occurrence.

\$14,000,000 excess of \$11,000,000 ultimate net loss each loss occurrence.

\$10,000,000 excess of \$25,000,000 each loss occurrence.

Loss Portfolio Transfer

In 1988, the Company executed an aggregate excess of loss reinsurance agreement with Centre Reinsurance Co. Ltd. that covered adverse development of assumed casualty reinsurance business currently being run off as well as direct casualty business in 1988 and future accident years. The agreement provided an aggregate limit of \$50 million, including a sub-limit of \$15 million for uncollectible reinsurance. In 1996, the Department required the Company to change the manner of accounting for this contract from reinsurance to loss portfolio transfer (“LPT”). Accordingly, the inception to date effect of the contract was eliminated in 1996 from the underwriting results and recorded as other income with no effect on net income and total surplus. As of December 31, 2003, the LPT account has a remaining balance of \$11.5 million.

Unauthorized Reinsurance

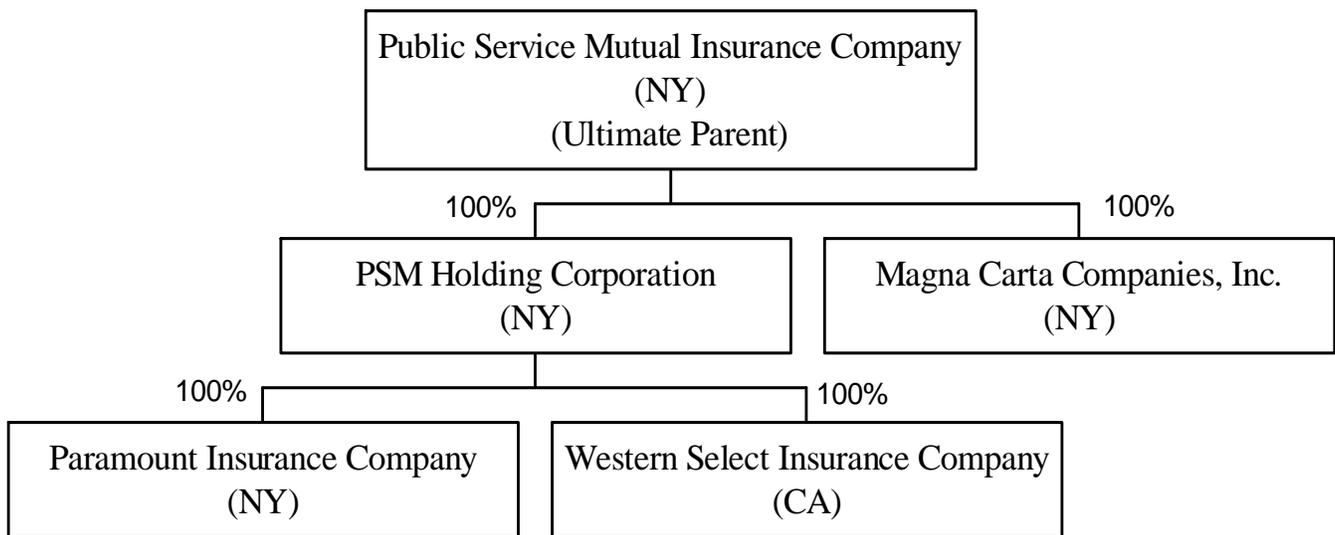
The letters of credit obtained by the Company in order to take credit for cessions made to unauthorized reinsurers were reviewed for compliance with Department Regulations 133. The review revealed no exceptions.

D. Affiliated Companies

The Company is a member of the Magna Carta Companies (“MCC”). PSM is the sole stockholder of PSM Holding Corporation, which in turn owns 100% of Paramount Insurance Company (“Paramount”), and 100% of Western Select Insurance Company (“WSI”), a California domiciled company.

A review of the Department Regulation 53 filings (subsidiaries reports) filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 16 of the New York Insurance Law and Department Regulation 53.

The following is a chart of the affiliated group at December 31, 2003:



PSM is the ultimate parent company and is a domestic mutual insurance company. Therefore, it is not subject to Article 15 of the New York Insurance Law.

On January 1, 2000, PSM and its subsidiaries ceased using the trade name PSM Insurance Companies and commenced marketing under the name, Magna Carta Companies (“MCC”).

In addition to the existing inter-company pooling and reinsurance agreement between PSM and Paramount and the quota share reinsurance agreement between PSM and WSI, the following agreements

in effect at December 31, 2003, with other members of its affiliated group, were filed with, and approved by the Department:

1. Service Agreement with Paramount and Western Select

Under this agreement, PSM makes available the services of its personnel, office space, equipment, and other services. The cost of such services with Paramount is shared consistent with the same rate of the pooling agreement. The fees charged to WSI are based upon the expenses incurred by PSM. The review of the allocation of expenses between the parties revealed that the charges are reasonable and in accordance with the requirements of Department Regulation No. 30.

2. Tax Allocation Agreement

Under this agreement, PSM, Paramount, WSI, PSM Holding Corporation and Magna Carta Companies, Inc. will file a consolidated income tax return with the Internal Revenue Service. The review of this agreement revealed that it is in compliance with Department Circular Letter No. 33 (1979).

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 of 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.

F. 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	93%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	91%
Premiums in course of collection to surplus as regards policyholders	13%

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	\$452,071,033	97.57%
Other underwriting expenses incurred	170,221,612	36.74
Net underwriting loss	<u>(158,986,213)</u>	<u>(34.32)</u>
Premiums earned	<u>\$463,306,432</u>	<u>100.00%</u>

G. Accounts and Records

i. Custodian Agreement with Bank of New York

The review of the Company's custodian agreement with Bank of New York revealed that the agreement lacks four of the twelve NAIC custodian agreement provisions. The provisions missing are as follows:

- a) That in the event that the custodian gains entry in a clearing corporation through an agent, there should be a written agreement between the custodian and the agent that the agent shall be subjected to the same liability for loss of securities as the custodian. If the agent is governed by laws that differ from the regulation of the custodian, the Commissioner of Insurance of the state of domicile may accept a standard of liability applicable to the agent that is different from the standard liability;
- b) The custodian and its agents, upon reasonable request, shall be required to send all reports which they receive from a clearing corporation or the Federal Reserve book-entry system which the clearing corporation or the Federal Reserve permits to be redistributed and reports prepared by the custodian's outside auditors, to the insurance company on their respective systems of internal control;
- c) That the custodian shall provide, upon written request from a regulator or an authorized officer of the insurance company, the appropriate affidavits, with respect to the insurance company's securities held by the custodian;
- d) That the custodian shall secure and maintain insurance protection in an adequate amount.

It was also noted that the Company's response to General Interrogatory No. 23 regarding custodian agreements was not accurately filled out.

It is recommended that the Company amend its custodian agreement to include all the protective covenants and provisions in order to comply with the requirements set forth in the NAIC Financial Condition Examiners Handbook and to Department guidelines.

Subsequent to the examination date, the Company amended its custodian agreement with the Bank of New York to include the missing provisions.

It is also recommended that the Companies respond accurately to General Interrogatory questions of the annual statement.

ii. Certified Public Accountants (“CPA”) Contract with KPMG LLP

The Company retains KPMG LLP as its independent certified public accountant for 2003. The review of the Company’s contract with KPMG for the 2003 audit revealed that the contract does not fully comply with the requirements specified in Section 89.2 of Department Regulation 118, as follows (underlined items represent the missing provisions):

“Every insurer subject to this Part shall retain an independent Certified Public Accountant (CPA) who agrees by written contract with such insurer to comply with the provisions of section 307(b) of the Insurance Law, this Part and the Code of Professional Conduct adopted by the American Institute of Certified Public Accountants (AICPA). Such contract must specify that:

- (a) on or before May 31st, the CPA shall provide an audited financial statement of such insurer and of any subsidiary required by section 307(b)(1) of the Insurance Law together with an opinion on 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 procedures and internal control systems as are necessary to the furnishing of the 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. For the purposes of this subdivision, the workpapers and communications shall be deemed to have been created on the date the filing required by section 89.2(a) of this Part was submitted to the superintendent.”

It is recommended that the Company ensure that the contract with its CPA firm complies with the requirements of Department Regulation 118.

iii. Claims Account Bank Reconciliation

As of December 31, 2003, the Company's bank reconciliation in its claims account showed a \$1.7 million irreconcilable difference, which has been accumulated for several years. The Company has indicated that this difference was due to a check processing problem in its computer system.

It is recommended that the Company correct the check processing problem to ensure that the claims account bank reconciliation will no longer show such irreconcilable difference.

It is noted that during the course of the examination, the Company made efforts to correct the system error. It is further noted that the difference decreased from \$1.7 million at December 31, 2003 to approximately \$680,000 as of the date of this report.

iv. Investment Reconciliation

During the review of the Company's investments, it was noted that there are several securities on special deposit at other banks. Many of these special deposits are listed on the Bank of New York ("BONY") statement as R/B/R (Registered by Receipt). These securities are designated as R/B/R since they are on deposit with another state and are not actually held by BONY. However, in some cases the state holding these special deposits was not noted in the reconciliation which look as if BONY holds the securities.

It is recommended that the Company, when performing an investment reconciliation, list on a separate column all of its special deposits with other states in order to facilitate the review of its investments.

v. Classification of Certificate of Deposits

It is noted during the review of Schedule E - Part 1 that the Company was reporting two certificates of deposits with maturities greater than one year as Cash.

According to the NAIC Annual Statement Instructions:

"Certificates of deposit in banks or other similar financial institutions with maturity dates of one year or less from the acquisition date and other instruments defined as cash in accordance with SSAP No. 2, Cash, Drafts, and Short-term Investments should be reported in this schedule. Long-term certificates of deposit are to be reported in Schedule D".

It is recommended that the Company classify securities in the correct annual statement line in future statements filed with the Department.

vi. Remittances and Items Not Allocated

The Company included two suspense accounts as an offset to the asset "Uncollected premiums and agents' balances in course of collection." The NAIC Annual Statement Instructions provides that liability line 15, "Remittances and items not allocated", should include the following:

"Report a liability for cash receipts that the insurer cannot identify for a specific purpose or, for other reasons, the insurer cannot apply to a specific account when received. Refer to SSAP No. 67, Other Liabilities, for accounting guidance. Include: items in suspense".

In addition, NAIC Accounting Practices and Procedures Manual, Statement of Statutory Accounting Principles ("SSAP") No. 67 - Other liabilities, Paragraph No. 9 states:

"Cash receipts cannot always be identified for a specific purpose or, for other reasons, applied to a specific account when received. The reporting entity shall record a liability for these cash receipts when the funds are received. These liability accounts are generally referred to as suspense accounts."

Based on the Annual Statement Instructions and NAIC Accounting Practices and Procedures Manual, Statement of Statutory Accounting Principles (“SSAP”) No. 67, the two suspense accounts should have been classified as “Remittances and items not allocated” and not as an offset against “Uncollected premiums and agents’ balances in course of collection” in the Company’s annual statement as of December 31, 2003.

It is therefore recommended that in future annual statement filed with this Department, the Company correctly classify annual statement accounts in accordance with the NAIC Annual Statement Instructions.

It is further recommended that the Company comply with SSAP No. 67 of the NAIC Accounting Practices and Procedures Manual and record suspense accounts as “Remittances and items not allocated.”

vii. Earned but Unbilled Premiums

Upon review of “Uncollected premiums and agents’ balances” reported on asset line 12.1 of the Company’s balance sheet, it was noted that this amount included audit premiums for workers’ compensation policies, which should have been reported as earned but unbilled (“EBUB”) premiums on line 12.2 as part of the “Deferred premiums, agents’ balances and installments booked but deferred and not yet due” and disclosed in parentheses on that line.

It is recommended that the Company properly classify audit premiums as earned but unbilled premiums and disclose in parenthesis in the “Deferred premiums, agents’ balances and installments booked but deferred and not yet due” line in the asset page of the annual statement.

viii. Electronic Data Processing (“EDP”) Equipment Depreciation

The Company depreciated its computer hardware using a seven-year straight line depreciation method. Pursuant to SSAP No. 79, EDP equipment and operating system software should be depreciated over the lesser of its useful life or three years.

No examination change has been made due to immateriality, however, it is recommended that the Company depreciate its EDP equipment in accordance with the provisions of SSAP No. 79.

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2003:

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$430,061,712	\$0	\$430,061,712
Preferred stocks	909,882	0	909,882
Common stocks	47,330,532	0	47,330,532
First liens - mortgage loans on real estate	4,853,107	0	4,853,107
Cash, cash equivalents and short-term investments	18,746,971	0	18,746,971
Investment income due and accrued	4,900,473	0	4,900,473
Uncollected premiums and agents' balances in the course of collection	20,973,911	2,513,960	18,459,951
Deferred premiums, agents' balances and installments booked but deferred and not yet due	14,588,409	0	14,588,409
Amounts recoverable from reinsurers	15,829,805		15,829,805
Funds held by or deposited with reinsured companies	6,646,608	0	6,646,608
Current federal and foreign income tax recoverable and interest thereon	1,173,879	0	1,173,879
Net deferred tax asset	12,350,000	0	12,350,000
Electronic data processing equipment and software	874,498	0	874,498
Furniture and equipment, including health care delivery assets	680,222	680,222	
Other assets non-admitted	116,035	116,035	0
Aggregate write-ins for other than invested assets	<u>6,713,112</u>	<u>1,491,160</u>	<u>5,221,952</u>
Total assets	<u>\$586,749,156</u>	<u>\$4,801,377</u>	<u>\$581,947,779</u>

Liabilities, Surplus and Other FundsLiabilities

Losses	\$306,587,242
Reinsurance payable on paid losses and loss adjustment expenses	6,758,517
Loss adjustment expenses	44,067,985
Commissions payable, contingent commissions and other similar charges	1,555,844
Other expenses (excluding taxes, licenses and fees)	1,659,172
Taxes, licenses and fees (excluding federal and foreign income taxes)	6,082,028
Unearned premiums	70,174,625
Policyholders (dividends declared and unpaid)	122,585
Ceded reinsurance premiums payable (net of ceding commissions)	1,473,623
Funds held by company under reinsurance treaties	588,999
Amounts withheld or retained by company for account of others	(36,165)
Provision for reinsurance	6,564,497
Net adjustments in assets and liabilities due to foreign exchange rates	1,088,106
Payable to parent, subsidiaries and affiliates	1,267,898
Aggregate write-ins for liabilities	<u>(10,054,713)</u>
Total liabilities	\$437,900,243

Surplus and Other Funds

Aggregate write-ins for special surplus funds	\$1,350,000
Aggregate write-ins for other than special surplus funds	11,450,952
Surplus notes	27,000,000
Unassigned funds (surplus)	<u>104,246,584</u>
Surplus as regards policyholders	<u>144,047,536</u>
Total liabilities, surplus and other funds	<u>\$581,947,779</u>

NOTE: The Internal Revenue Service has never audited the Company's consolidated Federal Income Tax returns. 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 by \$8,506,556 during the four-year examination period January 1, 2000 through December 31, 2003, detailed as follows:

Underwriting Income

Premiums earned		\$463,306,432
Deductions:		
Losses incurred	\$348,676,178	
Loss adjustment expenses incurred	103,394,855	
Other underwriting expenses incurred	170,052,479	
Aggregate write-ins for underwriting deductions	<u>169,133</u>	
Total underwriting deductions		<u>622,292,645</u>
Net underwriting gain or (loss)		\$(158,986,213)

Investment Income

Net investment income earned	\$114,758,064	
Net realized capital gain	<u>15,353,935</u>	
Net investment gain or (loss)		130,111,999

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$(2,549,421)	
Finance and service charges not included in premiums	634,949	
Aggregate write-ins for miscellaneous income	<u>1,237,231</u>	
Total other income		<u>(677,241)</u>
Net income / (Loss) before dividends to policyholders and before federal and foreign income taxes		\$(29,551,455)
Dividends to policyholders		<u>6,466,721</u>
Net income / (Loss) after dividends to policyholders but before federal and foreign income taxes		\$(36,018,176)
Federal and foreign income taxes incurred		<u>(2,600,000)</u>
Net loss		<u>\$(33,418,176)</u>

Capital and Surplus Accounts

Surplus as regards policyholders per report on
examination as of December 31, 1999 \$135,540,980

	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income		\$33,418,176	
Net unrealized capital gains or (losses)		1,168,812	
Change in net unrealized foreign exchange capital gain (loss)		708,496	
Change in net deferred income tax		1,295,000	
Change in nonadmitted assets	\$228,744		
Change in provision for reinsurance	211,096		
Change in surplus notes	27,000,000		
Cumulative effect of changes in accounting principles	17,535,195		
Aggregate write-ins for gains and losses in surplus	<u>122,005</u>	<u>0</u>	
Total gains and losses	<u>\$45,097,040</u>	<u>\$36,590,484</u>	
Net increase (decrease) in surplus			<u>8,506,556</u>
Surplus as regards policyholders per report on examination as of December 31, 2003			<u>\$144,047,536</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$350,655,227 is the same as reported by the Company as of December 31, 2003. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Companies internal records and in its filed annual statements.

In accordance with annual statement instructions, the Company is required to provide claims count data for claims reported, claims outstanding, and claims closed with payment in Schedule P of its filed annual statement. During the review of losses, data anomalies were noted in the claims count data reported in Schedule P - Part 5 of the Company's filed 2003 annual statement, as follows:

- Workers' Compensation business -For accident years 1994 through 1999, the cumulative number of claims reported decreased from year-end 2001 to year-end 2002.
- Other Liability - Occurrence - For accident year 1994, the cumulative number of claims reported decreased from year-end 1997 to year-end 1998.

It is recommended that the Company provide accurate claims count data and that the Schedule P be accurately completed in all future statements filed with the Department.

It is noted that the Company, after being notified of the data irregularities, corrected Schedule P in its 2004 filed annual statement.

5. MARKET CONDUCT ACTIVITIES

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

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

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

The following was noted upon review of the claims and complaint practices:

i. Department Regulation 64 Compliance

The review of a sample of complaints revealed that the Company did not respond to the Department within ten business days for two complaint cases as required by Section 216.4(d) of Department Regulation 64 which states in part:

“Every insurer, upon receipt of any inquiry from the Insurance Department respecting a claim, shall, within 10 business days, furnish the department with the available information requested respecting the claim”.

It is noted that the Company acknowledged this exception.

In addition, the Company’s claim files were reviewed for compliance with the provisions of Department Regulation 64. The review revealed the following:

The Company did not comply with the provisions of Section 216.6(c) of Department Regulation 64 which states in part:

“Within 15 business days after receipt by the insurer of a properly executed proof of loss and/or receipt of all items, statements and forms which the insurer requires from the claimant, the claimant, or the claimant’s authorized representative, shall be advised in writing of the acceptance or rejection of the claim by the insurer.”

There were two exceptions found for this specific section. It should be noted that the Company acknowledged these exceptions.

Furthermore, Section 216.6(f) of Department Regulation 64 states in part:

“Not later than 5 business days from the receipt of an agreement by the insurer or from the date of the performance by the claimant of any condition set by such agreement, insurer shall pay any amount finally agreed upon in settlement of all or part of any claim.”

There was one exception noted for this specific section. It should also be noted that the Company acknowledged this exception.

Section 216.11 of Department Regulation 64 states in part:

“To enable department personnel to reconstruct an insurer’s activities, all insurers subject to the provisions of this Part must maintain within each claim file all communications, transactions, notes and work papers relating to the claim. All communications and transactions, whether written or oral, emanating from or received by the insurer shall be dated by the insurer. Claim files must be so maintained that all events relating to a claim can be reconstructed by the Insurance Department examiners. Insurers shall either make a notation in the file or retain a copy of all forms mailed to claimants.” (Emphasis added.)

There was one exception noted for this specific section as the settlement release is not found in the file. In addition, as of the examination date, the Company did not retain copy of the acknowledgment letter sent to agents / claimants. Thus, the Company did not comply with this section for all claim files sampled.

It is recommended that the Company fully and strictly comply with the time requirement provisions of Sections 216.4 and 216.6 of Department Regulation 64. In addition, it is recommended that the Company fully comply with Section 216.11 of Department Regulation 64 and maintain within each claim file all communications, transactions, notes and workpapers relating to the claim as required by this specific section of Department Regulation 64.

The Company acknowledged that it did not routinely retain a copy of the acknowledgment card sent to agents / claimants notifying them that the claim has been received. It is noted that as of September 1, 2004, when the Company reverted from legal to letter size claim folders, copies of the claims acknowledgment cards became a permanent part of the claim folders.

ii. Complaints

The review of the Company's complaint logs for compliance with the requirements of Circular Letter No. 11 (1978) revealed that four of the eleven columns/items were not included, as follows:

1. The person within the company to whom the matter has been referred for review.
2. The date of such referral.
3. The chronology of further contacts with this Department.
4. Remarks about internal remedial action taken as a result of the investigation.

It is therefore recommended that the Company maintain a complaint log that comply with the requirements of Circular Letter No. 11 (1978).

The Company acknowledged that four of the eleven items mentioned in the circular letter are not evident in their log. As such, the Company indicated that, on a going forward basis, the complaint log will be redesigned to include the above-indicated four missing items to ensure compliance with the circular letter.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A. It was recommended that the Company maintain for each director rendering outside consulting services to Company individual formal written agreements approved by the board of directors.</p> <p>The Company has complied with this recommendation.</p>	5
<p>B.</p> <p>i. It was recommended that the parent company file with the Department the formation of the subsidiary, Magna Carta Companies Inc., pursuant to Section 1603 of the New York Insurance Law. In addition, it is recommended that the Company comply with the said statute in the future by notifying the Department prior to the formation of a subsidiary.</p> <p>The Company has complied with this recommendation.</p>	11
<p>ii. It was recommended that the parent company comply with the Circular Letter No. 33(1979) by filing with the Department an amended tax allocation agreement reflecting Magna Carta Companies, Inc. and Western Select Insurance Company as parties therein. In addition, it is recommended that those entities no longer affiliated with the Group be removed.</p> <p>The Company has complied with this recommendation.</p>	12
<p>iii. It was recommended that the Company revise its inter-company service agreement to refer to the State of New York instead of the State of California.</p> <p>The Company complied with this recommendation.</p>	12
<p>C. It was recommended that the Company maintain its records adequately to ensure that all claimants' names will be on record during each year in which unclaimed funds are escheated to the State, in accordance with Section 1316 of the New York Abandoned Property Law.</p> <p>The Company complied with this recommendation.</p>	14

<u>ITEM</u>	<u>PAGE NO.</u>
D.	
i.	14
It was recommended that all Company records be available upon request in a timely manner in order to facilitate future examination.	
The Company has complied with this recommendation.	
ii.	14
It was recommended that the Company prepare routine reconciliations of its invested asset accounts between the Company and custodial bank records.	
The Company has complied with this recommendation; however, in some cases the state holding the special deposits was not noted in the reconciliation. A recommendation relative to investment reconciliation is included in this current report on examination. (Refer to Item 7.C.iv.)	
iii.	15
It was recommended that the Company reconcile all its cash accounts to the bank statement in a timely manner.	
The Company has complied with this recommendation.	
iv.	15
It was recommended that the Company bill the reinsurers within the specified time call for in the agreement.	
The Company has complied with this recommendation.	
E.	20
It was recommended that the Company report accurate claim counts data in Schedule P of the filed annual statement.	
The Company has not complied with this recommendation during the examination period as anomalies in the claim counts data were also found. Therefore, this is being repeated in this current report.	

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
i. It is recommended that all officers and responsible employees complete conflict of interest questionnaires annually to disclose all possible conflicts to the board of directors.	5
ii. It is also recommended that the Company respond accurately to all General Interrogatory questions of the annual statement.	5,14
B. <u>Accounts and Records</u>	
i. <u>Custodian Agreement</u>	
It is recommended that the Company amend its custodian agreement to include all the protective covenants and provisions in order to comply with the requirements set forth in the NAIC Financial Condition Examiners Handbook and to Insurance Department guidelines.	14
ii. <u>CPA Contract</u>	
It is recommended that the Company ensure that the contract with its CPA complies with the requirements of Department Regulation 118.	15
iii. <u>Claim Account Bank Reconciliation</u>	
It is recommended that the Company correct the check processing problem to ensure that the claims cash account will no longer show an irreconcilable difference.	16
It is noted that during the course of the examination, the Company has made efforts to correct the computer system error. The Company has indicated that this difference has decreased from \$1.7 million at December 31, 2003 to approximately \$680,000 at January 31, 2005.	
iv. <u>Investment Reconciliation</u>	
It is recommended that the Company, when performing an investment reconciliation, list on a separate column all of its special deposits with other states in order to facilitate the review of its investments.	16

<u>ITEM</u>	<u>PAGE NO.</u>
v. <u>Classification of Certificate of Deposits</u>	
It is recommended that the Company classify securities in the correct annual statement line in future statements filed with the Department.	17
vi. <u>Remittances and Items Not Allocated</u>	
It is recommended that in future annual statement filed with this Department, the Company correctly classify annual statement accounts in accordance with the NAIC Annual Statement Instructions.	18
It is further recommended that the Company comply with SSAP No. 67 of the Accounting Practices and Procedures Manual and not record suspense accounts as an offset against Uncollected premiums and agents' balances in course of collection but rather as "Remittances and items not allocated."	18
vii. <u>Earned but Unbilled Premiums</u>	
It is recommended that the Company properly classify audit premiums as earned but unbilled premiums (EBUB) and disclose in parenthesis on the "Deferred premiums, agents' balances and installments booked but deferred and not yet due" line in the asset page of the annual statement.	18
viii. <u>EDP Equipment</u>	
It is recommended that the Company depreciate its EDP equipment in accordance with the provisions of SSAP No. 79.	19
C. <u>Loss and Loss Adjustment Expenses</u>	
It is recommended that the Company provide accurate claims count data and that the Schedule P be accurately completed in all future statements filed with the Department.	24
It is noted that the Company, after being notified of the data irregularities, corrected Schedule P in its 2004 filed annual statement.	
D. <u>Market Conduct Activities</u>	
i. <u>Department Regulation 64 Compliance</u>	
It is recommended that the Company fully and strictly comply with the time requirement provisions of Sections 216.4 and 216.6 of Department Regulation 64. In addition, it is recommended that the Company fully comply with Section 216.11 of Department Regulation 64 and maintain	27

ITEMPAGE NO.

within each claim file all communications, transactions, notes and workpapers relating to the claim as required by this specific section of Department Regulation 64.

ii. Complaints

It is recommended that the Company maintain a complaint log that comply with the requirements of Circular Letter No. 11 (1978).

27

The Company acknowledged that four of the eleven items mentioned in the Circular are not evident in their log. As such, they agreed, on a going forward basis, to redesign their complaint log to include the above-indicated four items as mentioned in the Circular to ensure compliance with the Department regulations on this matter.

Respectfully submitted,

_____/S/
Fe Rosales, C.F.E.
Senior Insurance Examiner

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

FE ROSALES, being duly sworn, deposes and says that the foregoing report, subscribed to by her, is true to the best of her knowledge and belief.

_____/S/
Fe Rosales

Subscribed and sworn to before me
this _____ day of _____, 2006.

Appointment No 22263

*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:*

Fe Rosales

as proper person to examine into the affairs of the

PUBLIC SERVICE MUTUAL 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 28th day of October, 2004





GREGORY V. SERIO
Superintendent of Insurance