

REPORT ON EXAMINATION  
OF THE  
SECURITY MUTUAL INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2005

DATE OF REPORT

SEPTEMBER 20, 2006

EXAMINER

GERARD L. FRANCO

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

Eliot Spitzer  
Governor

Eric R. Dinallo  
Superintendent

September 20, 2006

Honorable Eric R. Dinallo  
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 22486 dated April 5, 2006 attached hereto, I have made an examination into the condition and affairs of the Security Mutual Insurance Company as of December 31, 2005, and submit the following report thereon.

The examination was conducted at the Company's home office located at 2417 North Triphammer Road, Ithaca, New York 14850.

Wherever the designation "the Company" or "SMIC" appear herein without qualification, they should be understood to indicate the Security Mutual Insurance Company.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York Insurance Department.

## **1. SCOPE OF EXAMINATION**

The previous examination was conducted as of December 31, 2000. This examination covered the five-year period from January 1, 2001 through December 31, 2005, and was limited in scope to 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. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner. 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 certified public accountants.

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 organized in 1887 as the "Tompkins County Co-operative Fire Insurance Company" for the purpose of transacting business as a co-operative fire insurance corporation in Tompkins County, New York.

Subsequently, the territorial limits of the Company were extended to include all of the Counties of this State, and wherever authorized by law, any other States of the United States of America and the District of Columbia.

In 1935, a certificate was issued by the Department authorizing the Company to change its name to the "Tompkins Co-operative Fire Insurance Company."

Under the terms of an agreement of merger, effective in June 1957, the Company merged with the West Seneca Mutual Fire Insurance Association under the title and charter of the Tompkins Co-operative Fire Insurance Company.

Concurrent with the approval of the merger of Security Mutual Fire Insurance Company of Delhi, New York into the Tompkins Co-operative Fire Insurance Company, the latter was authorized in 1964 to change its corporate title to the Security Mutual Fire Insurance Company.

Subsequently, in 1964 the Company also merged with the Canton Co-operative Fire Insurance Company, of Canton, New York. Furthermore, on February 18, 1975, this Department approved the Company's current name of Security Mutual Insurance Company.

On April 27, 2004, this Department approved, pursuant to the provisions of Section 1307 of the New York Insurance Law ("NYIL"), the Company's request to issue a floating rate surplus note in the principal amount of \$5,000,000. The surplus note was issued on May 12, 2004 by SMIC, with a due date of 2034.

#### A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than nine nor more than thirteen members. As of the examination date, the board of directors was comprised of eleven members, which as stated in the Company's by-laws are to be 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.

Every member insured by the Company is entitled to one vote at any meeting of the members. The annual meeting of the board of directors is held immediately after the annual meeting of the Company. The board of directors met four times each year for the period under examination, to comply with Section 6624(b) of the NYIL.

The directors as of December 31, 2005, were as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
W. David Banfield Ithaca, NY	Insurance agent
Frederick S. Brown Ithaca, NY	Retired
Robert J. Clune Ithaca, NY	Attorney, General Council for Security Mutual Insurance Company

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Delbert L. Hall Dryden, NY	Secretary – Treasurer, Security Mutual Insurance Company
Joan H. Holden Lansing, NY	Retired
Stephen M. James Binghamton, NY	Retired and Vice President, Security Mutual Insurance Company
William H. Maddren Cortland, NY	Retired Insurance agent
Thomas R. Ruane Lansing, NY	President, Security Mutual Insurance Company
Roy E. Staley Ithaca, NY	Contractor
Robert B. Tallman Newfield, NY	Architect
Frederick S. Wilder Canton, NY	Retired Insurance agent

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 during the examination period was approximately 99% with each individual directors' attendance being adequate.

Each of the directors' qualifications, as set forth in Article III Section 1 of the Company's by-laws, were reviewed, and each director is duly qualified.

A review of the minutes of the board of directors for the examination period revealed that the Board approved the salaries of directors and officers and officers and employees bonuses.

At December 31, 2005, the officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Thomas R. Ruane	President
Delbert L. Hall	Secretary and Treasurer
Stephen M. James	Vice President

B. Territory and Plan of Operation

As of December 31, 2005, 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 defined in the following numbered paragraphs of Section 1113(a) of the NYIL:

<u>Paragraph</u>	<u>Line of Business</u>
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' Compensation and employers' liability
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine (inland marine only)

The Company was also licensed as of December 31, 2005, to accept and cede reinsurance as provided in Section 6606 of the NYIL.

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

<u>Calendar Year</u>	<u>Direct Premiums Written</u>
2001	\$29,631,653
2002	32,389,051
2003	35,862,595
2004	36,182,795
2005	36,293,850

Based on the lines of business for which the Company is licensed and the Company's current capital structure, and pursuant to the requirements of Articles 13, 41 and 66 of the NYIL, the Company is required to maintain a minimum surplus to policyholders in the amount of \$900,000.

The Company's predominate lines of business are homeowners and commercial multiple peril which accounted for 63.5% and 29.0%, respectively, of the Company's 2005 direct written business.

### C. Reinsurance

During the period covered by this examination, the Company did not assume any reinsurance business.

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

Property (2 layers)	\$1,330,000 x/s \$170,000 ultimate net loss each loss, each risk, subject to a further limit of liability to the reinsurer of \$3,990,000 each loss occurrence
Casualty (3 layers)	\$2,380,000 x/s \$120,000 ultimate net loss each loss occurrence
Property Catastrophe (5 layers)	95% of \$25,850,000 x/s \$1,150,000 ultimate net loss each loss occurrence
Facultative Property	15 times the Company's net retention each loss, subject to a minimum retention of \$50,000 and to a maximum cession of \$750,000 on any one risk plus reinsurer's pro-rata share of loss adjustment expense
Umbrella Facultative (2 layers)	95% of \$1,000,000 ultimate net loss, each loss occurrence, each policy on all business reinsured hereunder, plus reinsurer bound to pay its proportion of loss adjustment expense
	100% of \$4,000,000 x/s \$1,000,000 ultimate net loss, each loss occurrence, each policy, plus reinsurer bound to pay its proportion of loss adjustment expense

All the reinsurance contracts reviewed during the examination period were reinsured by authorized and unauthorized reinsurers, as was the case in the previous examination. Since the previous examination, the Company's net retention has increased from \$100,000 to \$170,000 on property business, and from \$90,000 to \$120,000 on casualty business.

All 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 NYIL.

Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in paragraph 25 of SSAP No. 62.

#### D. Holding Company System

The Company participates as a direct writer in any combination policy issued by New York Mutual Underwriters (“NYMU”). As of November 1997 the Company shares, with one other advance premium corporation one-half of all NYMU’s premiums, losses and expenses. NYMU’s predominate lines of business are commercial/special multiple peril, commercial landlord, personal dwellings and allied lines of business.

In 1998, SMIC organized a subsidiary, to be known as Security Mutual Brokers Services, Inc. (SMBS) pursuant to Section 1603 of the NYIL and this Department’s Regulation No. 53(NYCRR Part 81-1). SMBS was incorporated to act as a general insurance agency to accept applications for property/casualty insurance of all kinds.

#### E. Abandoned Property Law

Section 1316 of the New York State 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 abandoned property. Such abandoned property shall be reported to the comptroller on or before the first day of April each year. Such filing is required of all insurers regardless of whether or not they have any abandoned property to report.

The Company's abandoned property reports for the period of this examination were all filed on a timely basis pursuant to the provisions of Section 1316 of the New York State Abandoned Property Law.

## F. Significant Operating Ratios

The following ratios have been computed as of December 31, 2005, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	124%
Liabilities to liquid assets(cash and invested Assets less investments in affiliates)	67%
Premiums in course of collection to surplus as regards policyholders	7%

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

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

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$94,711,475	69.90%
Other underwriting expenses incurred	55,492.480	40.96%
Net underwriting loss	<u>(14,710,848)</u>	<u>(10.86)%</u>
Premiums earned	<u>\$135,493,107</u>	<u>100.00%</u>

## G. Accounts and Records

### i. Custodial Agreement

After a review of the Company's current custodial agreement, it was determined that several provisions and safeguards suggested by Department guidelines, as set forth in the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook, were omitted from such custodial agreement.

When this matter was brought to the attention of the Company, management contacted its custodial bank and the custodial agreement was revised to include the missing provisions.

Nevertheless, it is recommended that the Company ensure that its custodial agreements include all of the provisions specified in the NAIC Financial Condition Examiners Handbook and by the New York Insurance Department.

ii. Accounting Records of New York Mutual Underwriters

Section 6611(a)(1) of the NYIL states that; “Every co-operative property/casualty insurance company shall keep and maintain books of account and records in such manner as will show fully and truly the condition, affairs and business of such corporation and facilitate the preparation and verification of its annual statements.” As previously noted in Section 2.D, the Company participates as a direct writer in any combination policy issued by NYMU. As of November 1997 the Company shares, with one other advance premium corporation one-half of all NYMU’s premiums, losses and expenses. During the Department’s review of NYMU, it was noted that the accounting practices and procedures of NYMU did not facilitate preparation and verification of the annual statement of the Company. Therefore, it is recommended that the Company comply with Section 6611(a)(1) of the NYIL and maintain proper records and books of accounts at NYMU, which will allow for the verification of the reported amounts in its annual statements relative to its membership in NYMU.

It is noted that during the course of this examination, NYMU was in the process of converting to a new general ledger system.

### 3. FINANCIAL STATEMENTS

#### A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2005 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Examination</u>	
		<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$46,696,614	\$ 0	\$46,696,614
Common stocks	10,905,108	0	10,905,108
Properties occupied by the company	464,398	0	464,398
Cash, cash equivalents and short-term investments	3,534,843	0	3,534,843
Investment income due and accrued	548,967	0	548,967
Uncollected premiums and agents' balances in the course of collection	1,713,140	17,691	1,695,449
Deferred premiums, agents' balances and installments booked but deferred and not yet due	1,966,335	0	1,966,335
Amounts recoverable from reinsurers	1,313,484	0	1,313,484
Other amounts receivable under reinsurance contracts	68,576	0	68,576
Current federal and foreign income tax recoverable and interest thereon	57,492	0	57,492
Net deferred tax assets	93,580	0	93,580
Electronic data processing equipment and software	727,471	521,383	206,088
Furniture and equipment	166,960	166,960	0
Aggregate write-ins for other than invested assets	<u>912,071</u>	<u>754</u>	<u>911,317</u>
Totals	<u>\$69,169,039</u>	<u>\$706,788</u>	<u>\$68,462,251</u>

Liabilities, surplus and other funds

Losses and loss adjustment expenses		\$22,195,183
Commissions payable, contingent commissions and other similar charges		849,730
Other expenses (excluding taxes, licenses and fees)		306,128
Taxes, licenses and fees (excluding federal and foreign income taxes)		10,356
Unearned premiums		19,197,268
Ceded reinsurance premiums payable (net of ceding commissions)		175,862
Funds held by company under reinsurance treaties		7,273
Amounts withheld or retained by company for account of others		357,097
Provision for reinsurance		118,104
Drafts outstanding		<u>513</u>
Total liabilities		\$43,217,514
Aggregate write-ins for special surplus funds	\$ 900,000	
Surplus notes	5,000,000	
Unassigned funds (surplus)	<u>19,344,737</u>	
Surplus as regards policyholders		<u>25,244,737</u>
Totals		<u>\$68,462,251</u>

Note: The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2001 through 2005. 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 decreased \$408,643 during the five-year examination period January 1, 2001 through December 31, 2005, detailed as follows:

Underwriting Income

Premiums earned		\$135,493,107
Deductions:		
Losses and loss adjustment expenses incurred	\$94,711,475	
Other underwriting expenses incurred	<u>55,492,480</u>	
Total underwriting deductions		<u>150,203,955</u>
Net underwriting gain or (loss)		\$(14,710,848)

Investment Income

Net investment income earned	\$10,519,876	
Net realized capital gain	<u>2,576,486</u>	
Net investment gain or (loss)		13,096,362

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (94,050)	
Finance and service charges not included in premiums	2,938,731	
Aggregate write-ins for miscellaneous income	<u>(19,236)</u>	
Total other income		<u>2,825,445</u>
Net income before dividends to policyholders and before federal and foreign income taxes		\$ 1,210,959
Dividends to policyholders		<u>0</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$ 1,210,959
Federal and foreign income taxes incurred		<u>483,362</u>
Net Income		<u>\$ 727,597</u>

Surplus as regards policyholders per report on examination as of December 31, 2000			\$25,653,380
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$ 727,597	\$ 0	
Net unrealized capital gains or losses	0	5,541,774	
Change in net deferred income tax	1,853,509	0	
Change in nonadmitted assets	0	539,690	
Change in provision for reinsurance	0	118,104	
Cumulative effect of changes in accounting principles	0	1,790,181	
Change in surplus notes	<u>5,000,000</u>	<u>0</u>	
Net increase (decrease) in surplus			\$(408,643)
Surplus as regards policyholders per report on Examination as of December 31, 2005			<u>\$25,244,737</u>

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

The examination liability for the captioned items of \$22,195,183 is the same as reported by the Company as of December 31, 2005. 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 it filed annual statements.

It is noted that the Company's subsequent reported loss and loss adjustment reserve development appears to indicate that the loss and loss adjustment expense reserves as of December 31, 2005 for accident years 2005 and prior were deficient; however, the reported deficiency was not material enough to make an examination change.

## 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

No problem areas were encountered.

## **6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION**

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

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A.     <u>Annual Statement Schedule D – Part 1</u></p> <p>It was recommended that the Company follow the annual statement instructions by including all call option data in future financial statements submitted to this Department.</p> <p>The Company has complied with this recommendation.</p>	<p>9</p>
<p>B.     <u>Losses and Loss Adjustment Expenses</u></p> <p>It was recommended that the Company take the appropriate steps necessary to report adequate reserves for losses and loss adjustment expenses in accordance with Section 1303 of the New York Insurance Law.</p> <p>The Company has complied with this recommendation. However, a recommendation regarding monitoring of the Company’s lead paint claims development is made in this report.</p>	<p>14</p>
<p>C.     <u>Treatment of Policyholders and Claimants</u></p> <p>i.     It was recommended that the Company comply with Regulation 64 (NYCRR Part 216.11) by organizing their claim files in such a manner as to enable Insurance Department personnel to reconstruct all events relating to a claim.</p> <p>The Company has complied with this recommendation.</p> <p>ii.    It was recommended that the Company comply with Section 3425(d)(1) and 3426(e)(2) of the New York Insurance Law and give a more detailed description of the reason for the cancellation.</p> <p>The Company has complied with this recommendation.</p>	<p>15</p> <p>15</p>

**7. SUMMARY OF COMMENTS AND RECOMMENDATIONS**

<u>ITEM</u>		<u>PAGE NO.</u>
A.	<u>Accounts and Records</u>	
i.	It is recommended that the Company ensure that its custodial agreements include all of the provisions specified in the NAIC Financial Condition Examiners Handbook and by the New York Insurance Department.	8
ii.	It is recommended that the Company comply with Section 6611(a)(1) of the NYIL and maintain proper records and books of accounts at NYMU which will allow for the verification of the amounts reported in its annual statements relative to its membership in NYMU.	9



Appointment No 22486

STATE OF NEW YORK  
INSURANCE DEPARTMENT

I, Howard Mills, Superintendent of Insurance of the State of New York,  
pursuant to the provisions of the Insurance Law, do hereby appoint:

**Gerard Franco**

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

**Security 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 Albany,*

*this 5th day of April 2006*



A handwritten signature in cursive script, appearing to read "Howard Mills".

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Howard Mills  
Superintendent of Insurance