

REPORT ON EXAMINATION

OF

HEREFORD INSURANCE COMPANY

AS OF

DECEMBER 31, 2016

DATE OF REPORT

MAY 8, 2018

EXAMINER

VERONICA DUNCAN BLACK

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NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Maria T. Vullo
Superintendent

May 8, 2018

Honorable Maria T. Vullo
Superintendent
New York State Department of Financial Services
Albany, NY 12257

Madam:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 31623 dated April 14, 2017, attached hereto, I have made an examination into the condition and affairs of Hereford Insurance Company as of December 31, 2016, and submit the following report thereon.

Wherever the designation “the Company” appears herein without qualification, it should be understood to indicate Hereford 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 36-01 43rd Avenue, Long Island City, New York 11101.

1. SCOPE OF EXAMINATION

The Department has performed an examination of the Company, a multi-state insurer. The previous examination was conducted as of December 31, 2012. This examination covered the four-year period from January 1, 2013 through December 31, 2016. 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 current and 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 New York laws, statutory accounting principles, and annual statement instructions.

This examination report includes, but is not limited to, the following:

- Company history
- Management and control
- Territory and plan of operation
- Holding company description
- Reinsurance
- Loss review and analysis
- Financial statement presentation
- Summary of recommendations

A review was also made to ascertain what action was taken by the Company with regard to 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

Hereford Insurance Company was incorporated under the laws of the state of New York on October 5, 1982. It became licensed on April 1, 1986 and commenced business on the same day.

The Company is a wholly-owned subsidiary of Hereford Holding Company Inc. (“HHC”), a privately held corporation, which is ultimately controlled by Neil Greenbaum and Pearl Greenbaum. A 76.95% majority interest in HHC is held by Neil Greenbaum and Pearl Greenbaum collectively, with the remaining interest (23.05%) held by other investors.

A. Corporate Governance

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 seven nor more than twenty members. During the examination, the Company amended its charter to decrease its minimum number of directors from thirteen to seven. The Department approved the changes to the Company’s Amended and Restated Declaration and Charter on August 23, 2013 pursuant to Section 1206 of the New York Insurance Law. The board is required to meet at least four times during each calendar year, but only met once in 2013, and twice for calendar years 2014 through 2016. At December 31, 2016, the board of directors was comprised of the following eleven members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Richard Chin Wantagh, New York	Chief Operating Officer, Pearland Brokerage
Keith Greenbaum New York, New York	Senior Vice President and Treasurer, Hereford Insurance Company
Neil Greenbaum New York, New York	President and Secretary, Hereford Insurance Company
Pearl Greenbaum Boca Raton, Florida	Retired
Eugene Haber Garden City, New York	Partner, Colbert, Haber & Haber

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Barbara Hamill West Hartford, Connecticut	Vice President, Suburban Greater Hartford Realty Management Corp.
John Hamill West Hartford, Connecticut	President, Suburban Greater Hartford Realty Management Corp.
Kim Matus New York, New York	Director of Business Development, Pearland Brokerage
David Pollack Haverstraw, New York	Self-employed
Lou Trager Old Bridge, New Jersey	Retired
Annie Weinstein, Long Island, New York	Senior Vice President and Chief Operating Officer, Hereford Insurance Company

Board of Directors' Regular Scheduled Meetings

Article III, Section 10 of the by-laws states, in part:

“A regular annual meeting of the board shall be held immediately following the annual meeting of shareholders at the place of such annual meeting of shareholders. Other meetings of the board may be called by order of the chairman, the president, or the secretary or by a majority of the board. There shall be at least three such meetings held during the year.”

A review of the minutes of the board of directors' meetings shows that the board did not have at least three other meetings following the regular scheduled annual meeting as specified in the by-laws. It is recommended that the Company comply with Article III, Section 10 of the by-laws and have at least three board meetings during each calendar year following the regularly scheduled annual meeting.

Shareholders' Regular Scheduled Meeting

Article 7, Section A of the Amended and Restated Declaration and Charter states, in part:

“The annual meeting of the stockholders of the Corporation shall be held on the last Thursday of July each year.”

Article II, Section 2 of the by-laws states, in part:

“The annual meeting of the shareholders shall be held on the last Thursday of July in each year if not a legal holiday, and if a legal holiday, then on the next business day following at the same hour.”

A review of the minutes to the annual shareholders’ meetings shows that the annual shareholders’ meeting was not held on the last Thursday of July, as required by its charter and by-laws, for two of the four years under examination. It is recommended that the Company comply with Article 7, Section A of its Amended and Restated Declaration and Charter, and Article II, Section 2 of its by-laws, and consistently hold its annual shareholders’ meeting on the last Thursday of July each year.

Audit Committee Meetings

Article III, Section 13 of the by-laws states, in part:

“The board, by resolution adopted by a majority of the entire board, may designate from among its members an executive committee and other committees, each consisting of three or more directors.”

As indicated above, the audit committee is required to have three or more directors. At December 31, 2016, the audit committee had two directors. It is recommended that the Company comply with Article III, Section 13 of its by-laws and have a minimum of three directors on its audit committee.

As of December 31, 2016, the principal officers of the Company were as follows:

Name

Neil Greenbaum
Keith Greenbaum
Annie Weinstein

Title

President and Secretary
Senior Vice President and Treasurer
Senior Vice President and Chief Operating
Officer

B. Territory and Plan of Operation

Effective November 22, 2013, the Company became authorized to transact business in the state of New Jersey. As of December 31, 2016, the Company was licensed to write business in New York and New Jersey, but currently writes 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:

<u>Paragraph</u>	<u>Line of Business</u>
8	Glass
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
19	Motor vehicle and aircraft physical damage

Based upon 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 and 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$1,800,000.

The following schedule shows the direct premiums written by the Company for the period under examination. The Company did not assume any business.

<u>Calendar Year</u>	<u>Direct Premiums Written</u>
2013	\$104,215,824
2014	\$121,400,099
2015	\$128,809,383
2016	\$135,485,932

The Company is a property and casualty insurance carrier that services the for-hire transportation market in New York City. The Company writes commercial automobile liability, automobile physical damage, and workers' compensation insurance coverages, specializing in New York City Taxi & Limousine Commission ("NYCTLC") insurance for New York City medallions, for-hire vehicles (community based liveries, black cars, limousines, green cabs, app-based companies), and paratransit vehicles.

The Company also writes workers' compensation insurance for the New York Independent Livery Drivers Benefit Fund, Inc. ("ILDBF"). The workers' compensation benefits provided are for serious injuries and crimes committed against drivers dispatched by qualifying independent livery bases in New York City, and Westchester and Nassau counties.

The Company utilizes a network of independent brokers for the procurement of its workers' compensation and commercial automobile insurance business. As of December 31, 2016, insurance policies were distributed through a network of 118 insurance brokers, including its affiliates Pearland Brokerage, Inc. and HIC Business Services, LLC. Both Pearland Brokerage, Inc. and HIC Business Services, LLC have been deemed controlling producers pursuant to Department Regulation 52-A. The controlling producers are further discussed in section 2D of this report.

C. Reinsurance Ceded

For the period under examination, the Company had a reinsurance program in place to manage or mitigate any losses that may occur from its insurance business.

The Company has structured its ceded reinsurance program as follows:

<u>Type of Treaty</u>	<u>Cession</u>
<u>Commercial Automobile Liability and Workers' Compensation Quota Share</u>	<u>Commercial Automobile Liability:</u>
i. Sections A – C	42.5% quota share for policies classified as: A) automobile liability for certain New York public auto risks; B) automobile liability for AIPSO, maximum of 10 special New York livery units, ambulette.
ii. Section D	<u>Workers' Compensation:</u>

Type of TreatyCession

42.50% of \$125,000 per occurrence on certain public auto worker's compensation and employer's liability insurance business, including related class codes and limited for sanitation and gravel trucks.

- iii. All of the Additional Workers' Compensation Layers

Covering same business as listed above.

Commercial Automobile LiabilityPer Policy Excess of Loss

Three layers

\$1,700,000 excess \$300,000 ultimate net loss each and every occurrence – first \$50,000 of losses shall be retained by the reinsured.

For the period under examination, the Company's business was ceded solely to authorized reinsurers. The Company's primary reinsurer was Transatlantic Reinsurance Company whose reinsurance recoverables balances represented approximately 38% of the Company's surplus. A.M. Best has affirmed a credit rating of A+ for Transatlantic Reinsurance Company.

Statement of Statutory Accounting Principle ("SSAP") No. 62R, paragraph 8(d) states:

"The agreement must provide for reports of premiums and losses, and payments of losses, no less frequently than on a quarterly basis, unless there is no activity during the period. The report of premiums and losses shall set forth the ceding entity's total loss and loss expense reserves on the policy obligations subject to the agreement, so that the respective obligation of the ceding entity and the reinsurer will be recorded and reported on a basis consistent with this statement."

The Company's commercial automobile liability Per Policy Excess of Loss Reinsurance Agreement did not comply with SSAP No. 62R, paragraph 8(d). The agreement did not provide specific language as to the reporting and remittance of premium or losses as per SSAP No. 62R. It is recommended that the Company revise its commercial automobile liability Per Policy Excess of Loss Reinsurance Agreement to comply with SSAP No. 62R, paragraph 8(d).

Examination review found that the Schedule F data reported by the Company in its filed annual statement does not accurately reflect its reinsurance transactions with respect to the aging for reinsurance recoverables on paid losses and loss adjustment expenses as illustrated in Schedule F, Part 4 of the annual statement. The Company employs a manual process for the aging of its reinsurance recoverables balances. The process does not provide for the correct and/or proper determination of the past due reinsurance recoverable balances for the Company's excess of loss reinsurance contracts. It is recommended that the Company take the necessary steps to complete Schedule F, Part 4 accurately and in accordance with the NAIC annual statement instructions, to show the proper aging of the reinsurance recoverables balances on the paid losses and loss adjustment expenses.

A review of Schedule F, Part 7 and Part 8 shows that the Company did not complete these schedules. Part 7 accumulates overdue reinsurance balances for "authorized reinsurers". Part 8 calculates the reinsurance penalty for all overdue amounts. No examination change has been made for overdue reinsurance. Nonetheless, it is recommended that the Company complete Schedule F, Parts 7 and 8 in accordance with the NAIC annual statement instructions, to show any necessary penalties for overdue reinsurance recoverable balances with authorized reinsurers.

Management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62R. 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.

During the period covered by this examination, the Company commuted various reinsurance agreements. These commutations were neutral to the Company's surplus position.

D. Holding Company System

The Company is a member of the Hereford Holding Company, Inc. The Company is a wholly-owned subsidiary of HHC, a non-operating New York holding company, which is ultimately controlled by Neil and Pearl Greenbaum. As of the examination date, Mr. Neil

Greenbaum, the president of the Company, individually owned 64.12% of HHC's stock. The Company has relationships with other companies within the holding company system and common management with All Taxi Management, Thirty Six O One LLC, Pearland Brokerage, Inc. ("PBI"), and Pearland Insurance Brokerage LLC ("PIB").

During the examination period, HHC created three companies: Hereford Managing Services, LLC; HIC Business Services, LLC, and JAR, LLC. The companies were created to aid in managing Hereford's insurance business. Drivers Insurance Company, a subsidiary of HHC, was placed into liquidation on August 7, 2015 by the New York State Liquidation Bureau.

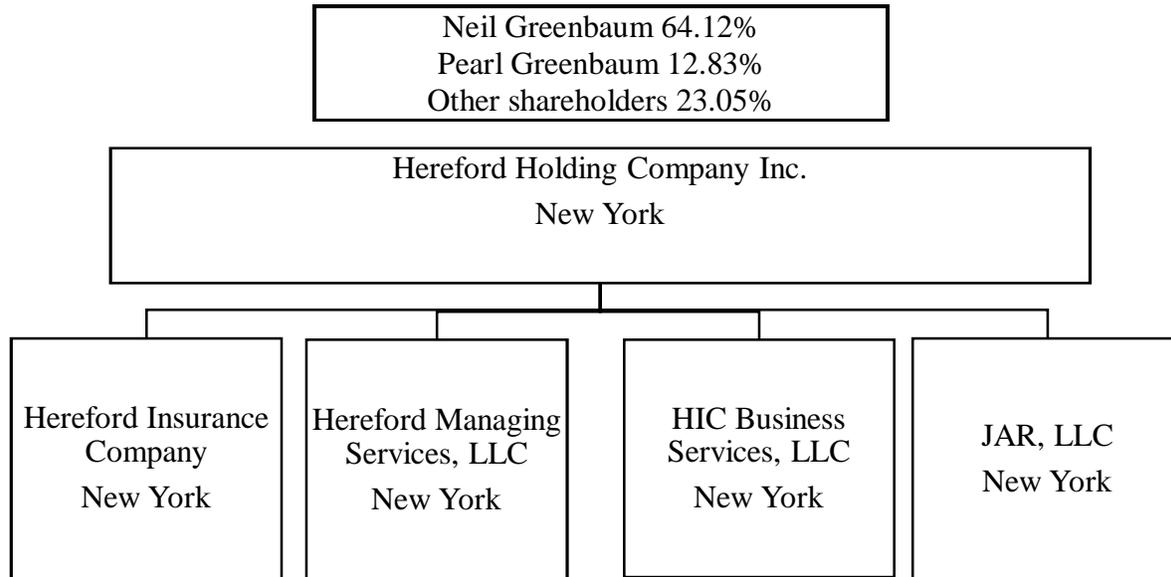
A review of the Holding Company Registration Statements filed with this Department during the examination period indicated that such filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

A review of the Controlling Producers Statements (Department Regulation 52-A) filed with the Department indicated that the filing for HIC Business Services, LLC was not submitted to the Department in a timely manner. Pursuant to Part 80-2.2 (C)(2) of New York Regulation 52-A:

"The controlled insurer shall annually, on or before April 1, provide to the superintendent:
a report consisting of the following: (i)(a) the amount of premiums on insurance business placed with the controlled insurer by the controlling producer; (b) the amount of commissions, charges or other fees paid by the controlled insurer to the controlling producer during the previous calendar year; and (c) the amounts owed to the controlling producer on the business by line of insurance on the annual statement; and (ii) the percentage that the amounts specified in subparagraph (i) of this paragraph represent of the controlled insurer's net premiums written for each such line of insurance."

The Company filed the controlling producer report for HIC Business Services, LLC on November 13, 2017. It is recommended that the Company file its controlling producer report in a timely manner pursuant to the provisions of Part 80-2.2 (C)(2) of Department Regulation 52-A.

The following is a chart of the holding company system at December 31, 2016:



Other entities having common ownership that do business with Hereford Companies are:

PBI: Common Ownership – Neil Greenbaum, Pearl Greenbaum, Barbara Hamill. PBI produces business for Hereford Insurance Company. None of the Hereford Companies has an equity interest in PBI.

PIB: Common Ownership – Neil Greenbaum, Keith Greenbaum, Max Greenbaum. PIB produces business for Hereford Insurance Company. None of the Hereford Companies has an equity interest in PIB.

All Taxi Management: Common Ownership – Neil Greenbaum. All Taxi Management is a taxi management firm. Insurance for individual taxis may be purchased through Pearland Brokerage, Inc. None of the Hereford Companies has an equity interest in All Taxi Management.

Thirty Six O One, LLC: Common Ownership – Neil Greenbaum, Pearl Greenbaum and Barbara Hamill. Thirty Six O One, LLC is the landlord for the space used by the Hereford Companies. None of the Hereford Companies has an equity interest in Thirty Six O One, LLC.

Holding Company Agreements

At December 31, 2016, the Company was party to the following agreements with other members of its holding company system:

Commercial Lease Agreement

Effective April 1, 2007, the Company entered into a lease agreement with Thirty Six O One, LLC. The original agreement provided for a ten-year rental of office and parking space. Effective February 1, 2015, the Company entered into an addendum to the lease agreement for additional office space and extended the original agreement for a 26-month period. This addendum to the lease agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law and was non-disapproved. The Company paid \$524,797 for rent expense in 2016.

Brokerage Agreement

Effective February 12, 1998 and amended June 27, 2003, the Company entered into a Brokerage Agreement with its controlling producer, Pearland Brokerage, Inc. to place business for the Company subject to New York Department Regulation 52-A. This agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law and was non-disapproved.

The following is a list of agreements with affiliates which did not have a significant or material impact on the Company's expenses as of December 31, 2016:

- Brokerage Agreement with Pearland Insurance Brokerage, LLC
- Brokerage and Management Agreement with HIC Business Services, LLC
- Management Agreement with Hereford Managing Services, LLC

These agreements were all filed with the Department pursuant to Section 1505 of the New York Insurance Law and were non-disapproved.

E. Significant Ratios

The Company's operating ratios have been computed as of December 31, 2016, based upon the results of this examination:

<u>Operating Ratios</u>	<u>Result</u>
Net premiums written to policyholders' surplus	452%
Adjusted liabilities to liquid assets	108%
Two-year overall operating	102%

It is noted that all the above ratios fall outside of the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners ("NAIC"). This is due to the examination adjustment to loss and loss adjustment expenses described in section 4 of this report.

Underwriting Ratios

The underwriting ratios presented below are on an earned/incurred basis and encompass the four-year period covered by this examination, based upon the results of this examination:

	<u>Amounts</u>	<u>Ratio</u>
Losses and loss adjustment expenses incurred	\$220,286,792	84.89%
Other underwriting expenses incurred	43,093,930	16.61
Net underwriting gain (loss)	<u>(3,890,073)</u>	<u>(1.50)</u>
Premiums earned	<u>\$259,490,649</u>	<u>100.00%</u>

The Company's reported risk based capital score ("RBC") was 302.1% at December 31, 2016. The RBC is a measure of the minimum amount of capital appropriate for a reporting entity to support its overall business operations in consideration of its size and risk profile. An RBC of 200 or below can result in regulatory action. The examination adjustments to the Company's losses and loss adjustment expense reserves, as described in section 4 of this report, impacted the Company's December 31, 2016 RBC score and brought it below 200. The Company recognized the losses and loss adjustment expense reserves deficiency as of December 31, 2017 and reported an RBC of 297.70%

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2016 as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$120,698,897		\$120,698,897
Preferred stocks	499,157		499,157
Common stocks	1,073,667		1,073,667
Cash, cash equivalents and short-term investments	16,075,636		16,075,636
Investment income due and accrued	1,661,488		1,661,488
Uncollected premiums and agents' balances in the course of collection	8,377,346	\$1,449,861	6,927,485
Deferred premiums, agents' balances and installments booked but deferred and not yet due	5,605,861		5,605,861
Amounts recoverable from reinsurers	12,770,277		12,770,277
Net deferred tax asset	3,377,000	822,000	2,555,000
Electronic data processing equipment and software	214,310	214,310	
Furniture and equipment, including health care delivery assets	193,439	193,439	
Receivables from parent, subsidiaries and affiliates	5,280,394		5,280,394
Other assets	698,223	698,223	
Leasehold improvements	<u>271,760</u>	<u>271,760</u>	<u>0</u>
Total assets	<u>\$176,797,455</u>	<u>\$3,649,593</u>	<u>\$173,147,862</u>

Liabilities, Surplus and Other FundsLiabilities

Losses and loss adjustment expenses	\$100,895,928
Commissions payable, contingent commissions and other similar charges	71,294
Other expenses (excluding taxes, licenses and fees)	1,171,415
Taxes, licenses and fees (excluding federal and foreign income taxes)	80,510
Current federal and foreign income taxes	599,707
Unearned premiums	20,163,901
Advance premium	8,135
Ceded reinsurance premiums payable (net of ceding commissions)	17,019,315
Amounts withheld or retained by company for account of others	1,802,492
Payable for securities	114,832
Premium deficiency reserves	<u>204,182</u>
Total liabilities	\$142,131,711

Surplus and Other Funds

Common capital stock	\$ 2,100,000
Gross paid in and contributed surplus	725,200
Unassigned funds (surplus)	<u>28,190,951</u>
Surplus as regards policyholders	<u>31,016,151</u>
Total liabilities, surplus and other funds	<u>\$173,147,862</u>

Note: The Internal Revenue Service has not examined the Company's Federal Income Tax returns during the audit period. Although tax years 2014-2017 remain open for examination by the Internal Revenue Service under the statute of limitations, the Company has not been notified of any pending examination. The Company is not aware of any potential exposure to any tax assessment and no liability has been established relative to such contingency.

B. Statement of Income

The net income for the examination period as reported by the Company was \$9,309,594 as detailed below:

Underwriting Income

Premiums earned		\$259,490,649
Deductions:		
Losses and loss adjustment expenses incurred	\$225,843,792	
Other underwriting expenses incurred	<u>43,093,930</u>	
Total underwriting deductions		<u>268,937,722</u>
Net underwriting gain or (loss)		\$(9,447,073)

Investment Income

Net investment income earned	\$11,785,625	
Net realized capital gain	<u>1,656,762</u>	
Net investment gain or (loss)		13,442,387

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ 421,008	
Finance and service charges not included in premiums	5,568,601	
Miscellaneous income	<u>2,071,544</u>	
Total other income		<u>8,061,153</u>
Net income before dividends to policyholders, and before federal income taxes		\$12,056,467
Dividends to policyholders		<u>1,473,616</u>
Net income, after dividends to policyholders, and before federal income taxes		\$10,582,851
Federal income taxes incurred		<u>1,273,257</u>
Net income		<u>\$9,309,594</u>

C. Capital and Surplus

Surplus as regards policyholders increased \$6,884,096 during the four-year examination period January 1, 2013 through December 31, 2016 as reported by the Company, detailed as follows:

Surplus as regards policyholders as reported by the Company as of December 31, 2012			\$24,132,055
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$9,309,594		
Net unrealized capital gains or losses	195,657		
Change in net deferred income tax	5,000		
Change in non-admitted assets		\$1,566,155	
Change in provision for reinsurance			
Capital changes paid in	1,100,000		
Surplus adjustments paid in	16,000		
Dividends to stockholders		1,600,000	
Prior period tax adjustment	<u>0</u>	<u>576,000</u>	
Total gains and losses	\$10,626,251	\$3,742,155	
Net increase (decrease) in surplus			<u>6,884,096</u>
Surplus as regards policyholders per Company as of December 31, 2016			<u>\$31,016,151</u>

The Company increased its authorized stock shares outstanding from 1,000,000 to 2,100,000 in 2013. The Department approved the capital increase on August 23, 2013 pursuant to Section 1206 of the New York Insurance Law.

As of December 31, 2016, the Company's paid in capital was \$2,100,000 consisting of 2,100,000 of \$1.00 par value per share common stock. Gross paid in and contributed surplus was \$725,200.

Gross paid in and contributed surplus increased by \$16,000 during the examination period, is follows:

<u>Year</u>	<u>Description</u>	<u>Amount</u>
2012	Beginning gross paid in and contributed surplus	\$709,200
2013	Surplus contribution	<u>16,000</u>
2016	Ending gross paid in and contributed surplus	<u>\$725,200</u>

D. Analysis of Changes to Surplus

Surplus as regards policyholders as of December 31, 2016, as reported by the Company			\$31,016,151
	<u>Surplus Increase</u>	<u>Surplus Decrease</u>	
Deferred tax asset non-admitted per SSAP No. 101	\$0	\$524,394	
Losses and loss adjustment expense reserves increase	<u>0</u>	<u>14,493,000</u>	
Total increase and decreases	0	15,017,394	
Net increase (decrease) in surplus			<u>(15,017,394)</u>
Surplus as regards policyholders as of December 31, 2016, after examination adjustments			<u>\$15,998,757</u>

E. Analysis of Changes to Income

Net income for the examination period, as reported by the Company			\$ 9,309,594
	<u>Income Increase</u>	<u>Income Decrease</u>	
Reversal of 12/31/2012 loss and loss adjustment expense adjustment	\$20,050,000	\$ 0	
Examination change in losses and loss adjustment expense reserves	0	14,493,000	
Prior period adjustment of federal income tax expense reflected through surplus	<u>0</u>	<u>576,000</u>	
Total increase and decreases	\$20,050,000	\$15,069,000	
Net increase (decrease) in income			<u>4,981,000</u>
Net income (loss) per report on examination			<u>\$14,290,594</u>

4. **LOSSES AND LOSS ADJUSTMENT EXPENSES**

The examination liability for the captioned items of \$115,388,928 is \$14,493,000 more than the \$100,895,928 reported by the Company in its filed annual statement as of December 31, 2016. The examination change is incorporated in Section 3D - Analysis of Changes to Surplus and Section 3E - Analysis of Changes to Income. The examination analysis of the loss and loss adjustment expense reserves was conducted in accordance with generally accepted actuarial principles and statutory accounting principles, including the NAIC Accounting Practices & Procedures Manual, SSAP No. 55.

By virtue of the Company's one-year runoff for accident years 2016 and prior, as reported by the Company in its filed December 31, 2017 annual statement, the Company has recognized the loss and loss adjustment expense reserves deficiency of \$14,493,000. Since the Department recommends a reserve increase equal to the Company's runoff and the Company has already acknowledged its runoff deficiency in its December 31, 2017 annual statement, no further changes to the Company's financial statements are required.

Going forward, it is recommended that the Company maintain adequate reserves pursuant to the provisions of Section 1303 of the New York Insurance Law and paragraph 10 of SSAP No. 55.

It is further recommended that the Company take the following steps to improve its loss and loss adjustment expense reserves projections:

- i) Enhance its loss ratio selections by year approach to be more quantitative and supportive and allocate its loss reserve liabilities accurately by accident year;
- ii) Review and update the formula currently in place that determines the appropriate allocation of the portion of defense and cost containment ("DCC") which comprises claims department and other related expenses between current and prior accident years; and,
- iii) Establish a manual reconciliation process to ensure the proper reconciliation of the U&I exhibits to Schedule P, Part 3 for net paid expenses.

5. NET DEFERRED TAX ASSET

The examination asset for the captioned item of \$2,030,606 is \$524,394 less than the \$2,555,000 reported by the Company in its December 31, 2016 filed annual statement.

Pursuant to paragraph 11(b) of SSAP No. 101, a reporting entity with risk based capital lower than two hundred percent should not admit certain components of the net deferred tax asset. The Company's RBC fell below 200% at December 31, 2016 due to examination changes. (See Section 2E of this report.)

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A. <u>Agents' balances</u></p> <p>It was recommended that the Company create and implement an aging report that would include the uncollected premium balances and not just the ones that are related to its workers' compensation business.</p> <p>The Company has complied with this recommendation.</p>	<p>10</p>
<p>B. <u>Classification of loss adjustment expenses</u></p> <p>It was recommended that the Company correctly classify its in-house legal department defense expenses as DCC and its general claims department overhead expenses as A&O, pursuant to the provisions of SSAP No. 55.</p> <p>The Company has complied with this recommendation.</p>	<p>15</p>

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Corporate governance</u>	
i. It is recommended that the Company comply with Article III, Section 10 of its by-laws and have at least three board meetings during each calendar year following the regularly scheduled annual meeting.	4
ii. It is recommended that the Company comply with Article 7, Section A of its Amended and Restated Declaration and Charter and Article II, Section 2 of its by-laws and consistently hold its annual shareholders' meeting on the last Thursday of July each year.	5
iii. It is recommended that the Company comply with Article III, Section 13 of its by-laws and have a minimum membership of three directors on its audit committee.	5
B. <u>Reinsurance</u>	
i. It is recommended that the Company revise its commercial automobile liability Per Policy Excess of Loss Reinsurance Agreement to comply with SSAP No. 62R, paragraph 8(d).	8
ii. It is recommended that the Company take the necessary steps to complete Schedule F, Part 4 accurately and in accordance with the NAIC Annual Statement Instructions, to reflect the proper aging of the reinsurance recoverables balances for the paid losses and loss adjustment expenses.	9
iii. It is recommended that the Company complete Schedule F, Parts 7 and 8 to show any necessary penalties for the overdue reinsurance recoverable balances with authorized reinsurers as required by the NAIC Annual Statement Instructions.	9
C. <u>Holding company system</u>	
It is recommended that the Company file its controlling producer report in a timely manner pursuant to the provisions of Part 80-2.2 of Department Regulation 52-A.	10

- D. Losses and loss adjustment expenses
- i. It is recommended that the Company maintain adequate reserves pursuant to the provisions of Section 1303 of the New York Insurance Law and paragraph 10 of SSAP No. 55. 20
 - ii. It is recommended that the Company enhance its loss ratio selections by year approach to be more quantitative and supportive and allocate its loss reserve liabilities accurately by accident year. 20
 - iii. It is recommended that the Company review its formula to determine the appropriate allocation of the portion of DCC which comprises claims department and other related expenses between current and prior accident years. 20
 - iv. It is recommended that the Company put in place a manual reconciliation process to ensure the proper reconciliation of the U&I exhibits and Schedule P, Part 3 for net paid expenses. 20

Respectfully submitted,

Veronica Duncan Black
Senior Insurance Examiner

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

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

Veronica Duncan Black

Subscribed and sworn to before me

this _____ day of _____, 2018

APPOINTMENT NO. 31623

NEW YORK STATE

DEPARTMENT OF FINANCIAL SERVICES

I, Maria T. Vullo, 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:

Veronica DuncanBlack

as a proper person to examine the affairs of the

Hereford Insurance Company

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

COMPANY

with such other information as she 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 14th day of April, 2017

*MARIA T. VULLO
Superintendent of Financial Services*



By:

Joan P. Riddell

*Joan Riddell
Deputy Bureau Chief*