REPORT ON EXAMINATION

OF THE

MIDSTATE MUTUAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2012

DATE OF REPORT	APRIL 17, 2014
EXAMINER	FRANK P. SCHIRALDI

TABLE OF CONTENTS

Andrew M. Cuomo
Governor

Benjamin M. Lawsky
Superintendent

April 17, 2014

Honorable Benjamin M. Lawsky
Superintendent of Financial Services
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 31032 dated September 3, 2013, attached hereto, I have made an examination into the condition and affairs of Midstate Mutual Insurance Company as of December 31, 2012, and submit the following report thereon.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate Midstate Mutual 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 5612 South Street Road, Auburn, NY 13021.

1. SCOPE OF EXAMINATION

The Department has performed an individual examination of the Company, a single-state insurer. The previous examination was conducted as of December 31, 2007. This examination covered the five-year period from January 1, 2008 through December 31, 2012. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination was conducted in accordance with the National Association of Insurance Commissioners ("NAIC") Financial Condition Examiners Handbook ("Handbook"), which requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. This examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process.

This examination report includes a summary of significant findings for the following items as called for in the Handbook:

Significant subsequent events
Company history
Corporate records
Management and control
Fidelity bonds and other insurance
Territory and plan of operation
Growth of Company
Loss experience
Reinsurance
Accounts and records
Financial statements
Summary of recommendations

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

This report on examination is confined to financial statements and comments on those matters that involve departures from laws, regulations or rules, or that are deemed to require explanation or description.

2. DESCRIPTION OF COMPANY

Midstate Mutual Insurance Company was organized under the laws of the State of New York in 1879 as the Farmers' Mutual Indemnity Association of Moravia, New York ("the Association"), for the purpose of transacting business as an assessment cooperative fire insurance corporation.

On April 8, 1986, the Department approved the merger of the Association with the Cayuga County Farmers Insurance Company, the Cayuga County Patrons' Fire Relief Association, the Farmers' Reliance Mutual Insurance Company and the Southern Tier Cooperative Insurance Company, with the Association being the surviving corporation under the title, Midstate Mutual Insurance Company.

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 seven nor more than eleven members. The board met four times during each calendar year during the examination period. At December 31, 2012, the board of directors was comprised of the following ten members:

Name and Residence	Principal Business Affiliation
Jeffery A. Armstrong Williamsville, NY	President, Baptist Life Association
Gregory N. Bruce Union Springs, NY	President and Chief Executive Officer, Midstate Mutual Insurance Company
James P. Chamberlain Auburn, NY	Secretary, Senior Vice-President, Midstate Mutual Insurance Company
Daniel J. Fessenden Union Springs, NY	Executive Director, Fred L. Emerson Foundation
John S. Fessenden King Ferry, NY	Manager, Farm Credit of Western, NY, ACA

Name and Residence	Principal Business Affiliation
Richard H. Flanagan Syracuse, NY	Instructor, New York State Office of Emergency Management
John A. Karpinski Auburn, NY	Attorney, Karpinski, Stapleton, Galbato, and Tehan, P.C.
Lyndon R. Odell Union Springs, NY	Professional Farm Manager
Andrew P. White Auburn, NY	Chief Investment Officer, Midstate Mutual Insurance Company
Michael L. White Clay, NY	Marketing Manager, McNeil and Co., Inc.

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member had an acceptable record of attendance.

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

Name	Title
Lyndon R. Odell	Chairman of the Board
Gregory N. Bruce	President and Chief Executive Officer
James P. Chamberlain	Secretary and Senior Vice-President
John S. Fessenden	Treasurer
Matthew A. Benedict	Executive Vice-President
Lesia M. Veit	Vice President
Joyce A. White	Vice President
John A. Gaines	Vice President
Andrew P. White	Chief Investment Officer

B. Territory and Plan of Operation

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

As of the examination date, the Company was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

Paragraph	Line of Business
4	Fire
5	Miscellaneous property
6	Water damage

Paragraph	Line of Business
7	Burglary and theft
8	Glass
9	Boiler and machinery
12	Collision
13	Personal injury liability
14	Property damage liability
15	Employers' liability
19	Motor vehicle
20	Inland marine

Paragraphs 5, 6, 7, 8, 13, 14 and 15 can be written solely in conjunction with fire insurance written under the same policy and covering the same premises. The Company is also authorized to accept and cede reinsurance as provided in Section 6606 of the New York Insurance Law.

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 and 66 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of $100,000.

The following schedule shows the direct premiums New York State during for the period under examination:

Calendar Year	New York State
2008	$11,429,716
2009	$12,716,276
2010	$13,716,138
2011	$14,042,726
2012	$14,125,099

The Company underwrote predominantly commercial multiple peril and homeowners multiple peril, which accounted for 53.0% and 38.2% of the 2012 direct written premium.

C. Reinsurance

During the current period under examination, the Company did not assume any reinsurance.

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

Property Excess of Loss (2 layers) 100% authorized	$950,000 excess of $300,000 ultimate net loss, each risk each loss, subject to a limit of liability to the Reinsurer of $950,000 each loss and $2,100,000 each loss occurrence.
Property Catastrophe Excess of Loss (4 layers) 100% authorized	Unlimited coverage excess of $300,000 ultimate net loss, each occurrence. No claim shall be covered unless the loss occurrence involves three or more risks.
Casualty Excess of Loss (3 layers) 100% authorized	$1,700,000 excess of $300,000 ultimate net loss, each loss occurrence, subject to a limit of liability to the Reinsurer of $2,700,000 each loss occurrence.
Property and Casualty Combined (1 layer) 100% authorized	$300,000 excess of $300,000 ultimate net loss each loss occurrence in the event of a loss involving at least one casualty policy and once property policy, subject to a limit of liability to the Reinsurer of $2,000,000 each loss occurrence.

The Company maintains pro-rata facultative reinsurance coverage for its property exposures for which cessions were limited to ten (10) times the Company's net retention plus the amount ceded to the Company's working reinsurance contracts, subject to a minimum net retention of $50,000 and a maximum cession of $1,750,000 any one risk.

The Company maintains facultative coverage for its casualty exposures for an ultimate net loss in excess of $1,000,000, subject to a limit of liability to the Reinsurer of $1,000,000 each loss occurrence, each policy. This contract also contains liability coverage for acts of terrorism with an aggregate limit of liability to the Reinsurer of $2,000,000.

In addition, the Company maintains quota share coverage whereby it cedes 100% of the liability and premium for its equipment breakdown business written on its policies and endorsements for equipment breakdown. Cessions by the Company for this coverage shall limit the liability to the Reinsurer to $5,000,000 on any one risk without prior approval of the Reinsurer.

All significant ceded reinsurance agreements in effect as of the examination date were reviewed and found to contain the required clauses, including an insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law.

Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62R. Representations were supported by an attestation from the Company's Chief Executive Officer pursuant to the NAIC Annual Statement Instructions. 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 did not commute any reinsurance agreements.

D. Holding Company System

As of December 31, 2012, the Company was not a member of any holding company system.

E. Significant Operating Ratios

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

Net premiums written to surplus as regards policyholders	57%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	45%
Premiums in course of collection to surplus as regards policyholders	2%

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

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

	Amounts	Ratios
Losses and loss adjustment expenses incurred	$40,941,837	73.91%
Other underwriting expenses incurred	21,777,578	39.31%
Net underwriting loss	(7,321,550)	(13.22%)
Premiums earned	$55,397,865	100.00%

F. Accounts and Records

Premium and Considerations

During the review of Premium and Considerations, it was noted that the Company under-reported this asset by $67,671 in its filed annual statement at December 31, 2012.

It is recommended that the Company correctly report the amount of Premium and Considerations in all subsequent filings with this Department.

During the review of bank reconciliations, it was noted that the Company did not always include details regarding deposits in transit including the date for these items, and in some cases the Company did not include itemized amounts for each deposit in transit, in its monthly reconciliation.

It is recommended that the Company formalize its bank reconciliation process so that deposits in transit and other reconciling items are enumerated and dated so as to facilitate ease of recognition, investigation and clearing of any stale-dated items. In addition, it is recommended that each bank reconciliation be signed and dated.

G. Risk Management and Internal Controls

A risk-focused assessment and review of the Company's controls was performed in accordance with NAIC requirements as outlined in the Examiners' Handbook. As a result of the review, it was noted that a few controls identified with the Company were not fully documented.

It is recommended that the Company fully document the existence and performance of each risk mitigation strategy in order for examiners to evaluate the existence of controls in place at the Company and to determine whether the control procedures are operating as expected and performed on a timely basis. Included in the documentation should be required sign-offs by the preparers and reviewers.

During the review of controls in Information Technology, it was noted that the Company did not test its Disaster Recovery Plan. It is recommended that the Company test its Disaster Recovery Plan at least once every five years.

During the review of controls in Information Technology, it was also noted that the Company stored backed up data tapes at an outside office of a local accountant. The Company does not have a contract with this accountant regarding the storage. In addition, the Company does not know what controls are maintained at the accountant's office.

It is recommended that the Company have a signed contract with any person or business that stores their backed up data. It is also recommended that the Company verify that there are adequate security measures at any site that stores the data.

3. FINANCIAL STATEMENTS

A Balance Sheet

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

Assets	Assets	Assets Not Admitted	Net Admitted Assets
Bonds	$28,817,481	$0	$28,817,481
Common stocks	4,848,845	0	4,848,845
Properties occupied by the company	647,141	0	647,141
Cash	710,133	0	710,133
Investment income due and accrued	271,726	0	271,726
Uncollected premiums and agents' balances in the course of collection	467,537	3,417	464,120
Deferred premiums, agents' balances and installments booked but deferred and not yet due	2,199,069	2,815	2,196,254
Amounts recoverable from reinsurers	148,088	0	148,088
Current federal and foreign income tax recoverable and interest thereon	100,000	0	100,000
Net deferred tax asset	1,269,300	563,800	705,500
Electronic data processing equipment and software	4,845	0	4,845
Furniture and equipment, including health care delivery assets	148,345	148,345	0
Cash surrender value of life insurance	98,457	98,457	0
Totals	$39,730,967	$816,834	$38,914,133

Liabilities	
Losses and loss adjustment expenses	$ 8,452,303
Commissions payable, contingent commissions and other similar charges	903,817
Other expenses (excluding taxes, licenses and fees)	148,591
Unearned premiums	6,981,760
Advance premium	76,242
Ceded reinsurance premiums payable (net of ceding commissions)	22,718
Remittances and items not allocated	26,452
Deferred compensation payable	1,030,650
Private pension plan liability	76,391
Total liabilities	$17,718,924
Unassigned funds (surplus)	21,195,209
Surplus as regards policyholders	$21,195,209
Totals	$38,914,133

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

B. Statement of Income

Surplus as regards policyholders decreased $336,181 during the five-year examination period January 1, 2008 through December 31, 2012, detailed as follows:

Premiums earned		$55,397,865
Deductions:		
Losses and loss adjustment expenses incurred	$40,941,837	
Other underwriting expenses incurred	21,777,578	
Total underwriting deductions		62,719,415
Net underwriting gain or (loss)		$(7,321,550)
Investment Income		
Net investment income earned	$ 5,182,003	
Net realized capital gain	414,159	
Net investment gain or (loss)		5,596,162
Other Income		
Finance and service charges not included in premiums	$ 836,191	
Aggregate write-ins for miscellaneous income	3,856	
Total other income		840,047
Net income after dividends to policyholders but before federal and foreign income taxes		$(885,341)
Federal and foreign income taxes incurred		(222,958)
Net Income		$(662,383)

	Gains in Surplus	Losses in Surplus	
Surplus as regards policyholders per report on examination as of December 31, 2007			$21,531,390
Net income		$ 662,383	
Net unrealized capital gains or (losses)	183,209		
Change in net deferred income tax	692,898		
Change in nonadmitted assets	0	549,905	
Net increase (decrease) in surplus	$876,107	$1,212,288	(336,181)
Surplus as regards policyholders per report on examination as of December 31, 2012			$21,195,209

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of $8,452,303 is the same as reported by the Company as of December 31, 2012. 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, Statement of Statutory Accounting Principle No. 55 ("SSAP No. 55"). The data underlying our analysis was derived from statistical information contained in the Company's internal records and its filed annual statements.

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

ITEM		PAGE NO.
A	Accounts and Records	9
i.	It was recommended that the Company ensure that the contract entered into with its independent certified public accountant be in full compliance with Department Regulation 118. The Company has complied with this recommendation.	
ii.	It was recommended that the Company comply with paragraph 6 of SSAP No. 26 by using the scientific method to calculate the amortization of bond premium or discount. The Company has complied with this recommendation.	10
iii.	It was recommended that the Company comply with the NAIC Annual Statement Instructions by reporting the actual amount of uncollected premiums and agents' balances in the course of collection, and deferred premiums, agents' balances and installments booked but deferred and not yet due in all future filings with this Department. The Company has not complied with this recommendation. A similar recommendation can be found in this report.	10
iv.	It was recommended that the Company accurately report, by accident year, its outstanding ceded loss adjustment expenses on Schedule P, part 1 in all future filings with this Department. The Company has complied with this recommendation.	10

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM			PAGE NO.
A.		Accounts and Records	
	i.	It is recommended that the Company report the correct amount of Premium and Considerations due in all subsequent filings with this Department.	8
	ii.	It is recommended that the Company formalize its bank reconciliation process so that deposits in transit and other reconciling items are enumerated and dated so as to facilitative ease of recognition, investigation and clearing of any stale-dated checks.	8
	iii.	In addition, it is recommended that each bank reconciliation be signed and dated.	8
B		Risk Management and Internal Controls	
	i.	It is recommended that the Company fully document the existence and performance of each risk mitigation strategy in order for examiners to evaluate the existence of controls in place at the Company and to determine whether the control procedures are operating as expected and performed on a timely basis. Included in the documentation should be required sign-offs by preparers and reviewers.	8
	ii.	It is recommended that the Company test its Disaster Recovery Plan at least once every five years.	8
	iii.	It is recommended that the Company have a signed contract with the person or business that stores their backed up data.	9
	iv.	It is also recommended that the Company verify that there are adequate security measures at any site that stores the data.	9

Respectfully submitted,

/s/

Frank P. Schiraldi
Senior Insurance Examiner

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

Frank P. Schiraldi, being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.

/s/

Frank P. Schiraldi

Subscribed and sworn to before me

this__________ day of ___________________, 2014.

APPOINTMENT NO. 31032

NEW YORK STATE

DEPARTMENT OF FINANCIAL SERVICES

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

Frank Schiraldi

as a proper person to examine the affairs of the

Midstate Mutual Insurance Company

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

COMPANY

with such other information as he shall deem requisite.

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

this 3rd day of September, 2013

BENJAMIN M. LAWSKY
Superintendent of Financial Services

By:

Jean Marie Cho
Deputy Superintendent