

REPORT ON EXAMINATION
OF THE
COLONIAL INDEMNITY INSURANCE COMPANY
AS OF
DECEMBER 31, 2001

DATE OF REPORT

NOVEMBER 8, 2002

EXAMINER

ANNIE LAU

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STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

November 8, 2002

Honorable Gregory V. Serio
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 21835 dated February 14, 2002 attached hereto, I have made an examination into the condition and affairs of Colonial Indemnity Insurance Company as of December 31, 2001, and submit the following report thereon.

The examination was conducted at the Company's administrative offices located at 999 Stewart Avenue, Bethpage, NY 11714.

Wherever the designations the "Company" or "Colonial" appear herein without qualification, they should be understood to indicate Colonial Indemnity 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, 1997. This examination covered the four-year period from January 1, 1998 through December 31, 2001, and was limited in scope to those balance sheet items considered by this Department to require analysis, verification or description, including: invested assets, agents' balances and uncollected premiums, reinsurance recoverable, losses and loss adjustment expenses, reinsurance payable, provision for reinsurance and inter-company transactions. In addition, the following items were also reviewed:

- History of Company
- Management and control
- Corporate records
- Territory and plan of operation
- Loss experience
- Reinsurance
- Accounts and records
- Financial statements
- Market conduct activities

Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

2. DESCRIPTION OF COMPANY

A. History

Colonial Indemnity Insurance Company was incorporated under the laws of the State of New York on September 13, 1961, as Charter Indemnity Company ("Charter"). It became licensed on August 24, 1962 and commenced business shortly after that.

All of the outstanding capital stock was originally held by the Independent Life and Accident Insurance Company, of Louisville, Kentucky. In July of 1982, Charter's parent was acquired by the Independent Life and Accident Insurance Company, of Jacksonville, Florida. On December 7, 1983, all the outstanding shares of Charter were transferred via stock dividend to the Independent Life and Accident Insurance Company, of Jacksonville, Florida.

On February 28, 1986, all the outstanding capital stock of Charter Indemnity Company was purchased by Kingston Holding Company, Inc., a Delaware company with its home office in New York City. On March 10, 1986, the Company amended its certificate of incorporation and changed its name to Colonial Indemnity Insurance Company.

On December 30, 1994, the Department granted approval to Mr. William Wallach to acquire control of the Company through a purchase of 100% of the voting common stock of the Company from Kingston Holding Company, Inc. by BW Holding Corp. ("BW Holding"). The closing for the acquisition did not occur until January 9, 1995.

On March 19, 1996, Eagle Insurance Company ("Eagle") filed its application for the acquisition of control of the Company pursuant to Section 1506 of the New York Insurance Law via an assignment and assumption agreement with The Robert Plan Corp. ("Robert Plan") whereby Robert Plan assigned to Eagle its right to purchase the Company under a stock agreement executed by the Robert Plan, BW Holding, and William Wallach.

On August 5, 1996, the Department granted the approval for the acquisition of the Company by Eagle Insurance Company. As of December 31, 2001, the Company is a wholly-owned subsidiary of

Eagle Insurance Company, the intermediate holding company. The Robert Plan Corp. is the ultimate parent.

Capital paid in is \$2,500,000 consisting of 500,000 shares of common stock at \$5.00 par value per share. Gross paid in and contributed surplus is \$6,105,466. Capital and paid in and contributed surplus have not changed from the previous examination date.

B. 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 thirteen nor more than twenty-one members. The board meets annually. At December 31, 2001, the board of directors was comprised of the following thirteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Simha Chandran Rego Park, NY	Senior Vice President Robert Plan Corporation
Lisa Ann Drillich Hewlett, NY	Vice President and Associate General Counsel, Robert Plan Corporation
Marie Julia Grossman Mt. Holly, NY	Senior Vice President of NY and NJ, Robert Plan Corporation
Jasper John Jackson, Jr. Montclair, NJ	Senior Executive Vice President and General Counsel, Robert Plan Corporation
Kenneth John Karasinski Sodus Points, NY	Branch Operations Manager, Robert Plan Corporation
John Lusardi Hazlat, NY	Senior Vice President of Operation, Robert Plan Corporation
Philbert Anthony Nezamoodeen East Rockaway, NY	Vice President, Treasurer and Chief Operating Officer, Robert Plan Corporation

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Robert Palm Fairfield, CT	Chief Financial Officer and Chief Actuary, Robert Plan Corporation
Stephen Frank Paparo Ft. Salonga, NY	Senior Vice President, Robert Plan Corporation
John David Reiersen Port Jefferson, NY	Senior Executive Vice President, Robert Plan Corporation
Sally Anne Udalovas Eatons Neck, NY	Vice President of SIU, Robert Plan Corporation
Robert Matthew Wallach Mill Neck, NY	Chairman and Chief Executive Officer, Robert Plan Corporation
William Wallach Lauderhill, FL	Chairman Emeritus, Robert Plan Corporation

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended with the exception of Mr. William Wallach, whom attended less than 50% of the meetings for which he was eligible to attend.

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

As of December 31, 2001, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Philbert Anthony Nezamoodeen	President
Jasper John Jackson, Jr.	Secretary
Robert Palm	Treasurer
John David Reiersen	Vice Chairman and Vice President
Paul Michael Alliegro	Controller

The Company was not able to provide documentation indicating that a copy of the prior report on examination was received and read by its board of directors. Pursuant to Section 312(b) of the New York Insurance Law, "A copy of the report shall be furnished by such insurer or other person to each member of its board of directors and each such member shall sign a statement which shall be retained in the insurer's files confirming that such member has received and read such report." It is recommended that the Company retain signed statements from each of its board members indicating that they have received and read the report on examination, as required by Section 312(b) of the New York Insurance Law.

The Company has not complied with Article II, Section 2 of its by-laws effective April 1, 1992, which specifies that regular meetings of the board shall be held four times a year. The Company only held three meetings in 1998 and 1999, two meetings in 2000 and one meeting in 2001. Therefore, it is recommended that the board of directors meet four times per year as required by Article II, Section 2 of its by-laws.

Section 6 of the amended charter effective October 8, 1992, specifies that the annual meeting of the stockholders shall be held on the second Thursday of May of each year. However, the stockholders' meetings were held in April of 1998 and 1999, July 2000 and October 2001. Therefore, it is recommended that the Company hold its stockholders' meetings on the date specified in Section 6 of its amended charter.

C. Territory and Plan of Operation

As of December 31, 2001, the Company was licensed to write business in New York, Kentucky and South Carolina. However, the Company only wrote in New York during the examination period. It was noted that the Company is licensed to write fidelity and surety insurance in Kentucky, for

which it does not have such authority in its New York license. This appears to be a violation of Section 1102(b) of the New York Insurance Law which stated as follows:

“No corporation organized under any law of this state shall do an insurance business outside this state unless so authorized pursuant to the provisions of this chapter or exempted by the provisions of this chapter from such requirement.”

Therefore, it is recommended that the Company amend its Kentucky license to match its New York license in comply with Section 1102(b) of the New York Insurance Law.

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	Worker's compensation and employer's liability
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity
30	Substantially similar kind

The Company is also authorized to write such workers' compensation insurance as may be incident to coverages contemplated under paragraphs 20 and 21 of Section 1113(a), including insurances

described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69th Congress as amended; 33 USC Section 901 it seq. as amended).

Based on the lines of business for which the Company is licensed, the Company's current capital structure and 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 \$3,100,000.

The Company writes mainly general liability, commercial multiple peril, commercial automobile and private passenger automobile business. The Company markets its business through independent agents and brokers.

The following schedule shows the direct premiums written by the Company during the examination period, the direct premiums written in New York State, and the percentage the New York premiums bear to the countrywide premiums.

<u>Calendar Year</u>	<u>New York State</u>	<u>Total United States</u>	<u>Percentage of New York State Direct Premiums Written to Countrywide Premiums</u>
1998	\$10,674,549	\$10,674,549	100.00%
1999	9,444,534	9,444,534	100.00
2000	10,041,332	10,041,332	100.00
2001	<u>6,981,705</u>	<u>6,981,705</u>	<u>100.00</u>
Total	<u>\$37,142,120</u>	<u>\$37,142,120</u>	<u>\$100.00%</u>

D. Reinsurance

Assumed

As of December 31, 2001, the Company did not assume any reinsurance. The Company participated in a pooling arrangement with Colonial Co-operative Insurance Company (“Co-op”) effective April 1, 1988, which was terminated as of December 31, 1997. Currently, this business is in run-off. An arbitration proceeding had commenced between the Company and Co-op to determine the rights of the parties pursuant to the termination of the agreement. The Company sought to recover damages from Co-op’s directors and officers for breach of their fiduciary duties. The arbitration was settled in April 2002 and the Company received \$37,500 in settlement.

The examiner noted that the assumed paid loss and case reserve reported in Schedule F Part 1 of the Company’s 2001 annual statement did not reflect the correct assumed balance.

It is recommended that the Company exercise greater care in preparing its annual statement and assure that Schedule F and all other schedules are reconciled.

Ceded

All ceded reinsurance contracts in effect at December 31, 2001 were reviewed. The contracts all contained the required standard clauses including insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

At December 31, 2001, the Company ceded a 90% quota share of its business to its parent, Eagle Insurance Company. The quota share reinsurance agreement became effective January 1, 1998 and was

approved by this Department on June 29, 1998. All other reinsurance agreements were in run-off as of the examination date.

E. Holding Company System

The Company is a member of The Robert Plan Corp. The Company is 100% owned by Eagle Insurance Company, which in turn is ultimately controlled by The Robert Plan Corp.

A review of the Holding Company registration statements filed with this Department indicated that such filings were complete and were filed on a timely basis pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

Schedule Y

A review of Schedule Y, Part 2 of the 2001 annual statement indicated that the Company did not properly report the inter-company transactions occurred during 2001. In addition, several affiliates were omitted in the organization chart in Schedule Y, Part 1.

It is recommended that the Company properly report its holding company structure in Schedule Y, Part 1 and the inter-company transactions in Schedule Y, Part 2.

The following is a chart of the holding company system at December 31, 2001:

The Robert Plan Corporation
Delaware

Eagle Insurance Company
New Jersey

Urban Underwriters, Inc.
Florida

Lion Insurance Company
New York

National Consumer Insurance Company
New Jersey

Newark Insurance Company
New Jersey

Urban Insurance Company of PA
Pennsylvania

GSA Insurance Company
New Jersey

Colonial Indemnity Insurance Company
New York

Commercial Mutual Insurance Company
New York
(Eagle has a surplus note investment in this Company and has control of the board of directors)

New American Insurance Company
Florida

The Robert Plan of New York Corp.
New York
(Insurance Agency)

Freedom General Agency
Texas

Freedom Premium Finance Company
Texas

Jersey Central Insurance Agency
New Jersey

The Robert Plan of CA
California
(Insurance Agency)

Robert Transco Corporation
New York

At December 31, 2001, the Company was a party to the following agreements with other members of its holding company system:

Claims Service Agreements for Pre-June 1994 claims and Post-June 1994 claims

The Company entered two claims service agreements with Material Damage Adjustment Corp. (“MDA”). The pre-June 1994 agreement covers claims occurred prior to June 1, 1994 and the post-June 1994 agreement covers claims occur on and after June 1, 1994. The Company filed the agreements with the Department after they were implemented. The Company was cited for non-compliance of Article 15 of the New York Insurance Law in the prior report on examination. Initially, the Department disapproved the agreements and ordered the Company to immediately seek reimbursement from MDA for all fees improperly paid. In addition, the Department ordered the Company to re-establish the loss adjustment expense reserves at the level required by Section 1303 and Section 4117 of the New York Insurance Law. For the pre-June 1994 agreement, MDA returned \$628,000 of the fees (“1996 remaining fee”) to the Company. In addition, the Company re-submitted the pre-June 1994 agreement with amendment No. 1 for approval. The Department approved the original agreement and amendment No. 1 on July 10, 1996 after the Company included the fee deferral clause in Amendment No. 1 as follows:

“On the 15th day of each quarter, the Company shall pay 16.5% of all claims payments for the covered claims.

- (a) At the same time, the Company shall pay MDA the positive amount resulting from the difference between:
 - (i) 1996 remaining fee of \$628,000 less MDA fees paid in accordance with (i) above and
 - (ii) 16.5% of actual loss reserves including IBNR reserves for each quarter end (“1996 True Up Payment”)
- (b) In no event will the total payment exceed \$628,000.”

The agreement was terminated as of December 31, 2001.

For the post-June 1994 agreement, MDA returned \$1,375,000 of the fees (“1996 1st period fee”) to the Company and the Company re-submitted the post-June 1994 agreement with amendment No. 1 for approval. On July 10, 1996, the Department approved the original contract and amendment No.1 in compliance with Section 1505(a) of the New York Insurance Law. The amendment requires the Company to pay MDA on a deferral basis for two periods as follows:

“First period started from inception to December 31, 1995. Second period started from January 1, 1996 and on.

- (a) Starting January 1, 1996, for the \$1,375,000 returned by MDA, the Company shall pay MDA as follows:
- (i) On the 15th day after the end of each quarter, the Company shall pay MDA a total fee amount equal to 16.5% of all claims payments (losses paid) made during the quarter relating to covered claims (“MDA Fee”);
 - (ii) At the same time, the Company shall pay MDA the positive amount resulting from the difference between:
 - (x) 1996 remaining 1st period fee less MDA Fee paid accordance to (i) above, and
 - (y) The amount equal 16.5% of the actual loss reserves, including IBNR reserves, relating to 1st period covered claims at the end of the quarter (“1996 true up payment”).
 - (iii) In no event will the total payment to MDA under (i) and (ii) above exceed \$1,375,000.
- (b) For the services rendered in the second period, the Company shall pay MDA 17% of earned premiums. The fee shall be billed monthly based on the following schedule of amortization percentages and settle with 30 days (“the Belkin Method”):

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8
BI	28.01%	26.16%	13.28%	5.37%	7.17%	8.16%	8.09%	3.77%
PIP	42.96%	33.87%	7.92%	1.83%	4.96%	5.76%	2.71%	
Auto PD	51.62%	13.32%	4.40%	9.60%	21.05%			
Physical Damage								”
Auto	90.43%	9.26%	0.31%					

The Company subsequently entered into four more amendments to the post-June 1994 agreement. The other amendments were either disapproved due to violations of filing requirements set forth in Section 1505(d) of the New York Insurance Law or to failure to meet conditions set forth by the

Department for the approval. As the result, the Company did not implement the subsequent amendments. The agreement with MDA was terminated as of December 31, 2001.

Starting January 1, 2002, Colonial authorized Commercial Mutual Insurance Company (“Commercial Mutual”) to handle all Colonial administrative functions and certain claims functions for commercial automobile business. MDA continues to run-off general liability claims and private passenger automobile claims.

Tax Allocation Agreement

The tax allocation agreement is between the Robert Plan Corporation “the Parent” and its subsidiaries. This agreement was dated May 1, 1993 and amended effective December 6, 1996 to add additional subsidiaries acquired subsequent to May 1, 1993, which included Colonial Indemnity Insurance Company. The Department approved both the tax allocation agreement and the amendment pursuant to the requirements of Department Circular Letter No. 33 (1979).

Policy Administration and Servicing Agreement

The policy administration servicing agreement was dated January 1, 1999, between Colonial Indemnity and Commercial Mutual Insurance Company. Under the terms of this agreement, Colonial agrees to provide administration services for all Commercial Mutual written policies in accordance with all applicable laws, insurance department regulations, order and/or directives. The Company obtained non-disapproval from the Department. The agreement was amended on January 1, 2002, which basically reversed the original agreement. Colonial no longer has any employees and the agreement authorized Commercial Mutual to handle all Colonial’s administrative functions and certain claims functions for

commercial automobile business. The amendment was not submitted to the Department for approval on a timely basis as required by Section 1505(d) of the New York Insurance Law.

Section 1505(d)(3) of the New York Insurance Law states:

“The following transactions between a domestic controlled insurer and any person in its holding company system may not be entered into unless the insurer has notified the superintendent in writing of its intention to enter into any such transaction at least thirty days prior thereto, or such shorter period as he may permit, and he has not disapproved it within such period:

...(3) rendering of services on a regular systematic basis.”

Therefore, it appears that the Company has violated Section 1505(d)(3) of the New York Insurance Law by failing to file its revised policy administration servicing agreement with the Department on a timely basis.

It is also recommended that the Company comply with the filing requirements set for in Section 1505(d) of the New York Insurance Law and file all inter-company agreements with the Department on a timely basis.

F. Accounts and Records

CPA Contracts and Reports

During the examination period, the written contracts between the Company and its independent certified public accountant (“CPA”) did not meet the requirements set forth in Regulation 118 and 152. The contract entered between Arthur Andersen, LLP (“Andersen”) and the Company for 1999 states that Andersen will retain the workpapers for not less than five years. Regulation 118 requires that audit workpapers and communications must be retained by the CPA for the period specified in Part 243.2(b)(7) and (c) of Regulation 152 which is six years from its creation or until after the filing of the report on

examination in which the record was subject to review, whichever is longer. The contract with Andersen for 2000 and with BDO Seidman LLP for 2001 and 2002 do not contain any of the Regulation 118 and 152 provisions.

Therefore, it is recommended that the Company maintain a written contract with its independent certified public accountant that complies with record retention and other provisions set forth in Department Regulation 118 and 152. A similar recommendation was made in the three previous reports on examination. It is also recommended that the Company amend the contract with BDO Seidman LLP in order to comply with Regulation 118 and 152.

The prior report on examination cited the Company for not filing the audited financial statement together with the opinion of the independent certified public accountant within five months of the end of each calendar year. It is recommended that the Company adhere to Section 307(b) of the New York Insurance Law henceforth and file its annual CPA report in accordance with the time frame prescribed by such section. A review of the CPA report filings during the current examination period indicated the Company did not comply with the recommendation. The 2000 CPA report was not completed until April 2002 and the Company filed the report in September 2002. As of the date of this report, the audit for 2001 has not been completed.

It is again recommended that the Company file its CPA report with the Department in accordance with the time frame prescribed by Section 307 of the New York Insurance Law. A similar recommendation was included in the three previous reports on examination.

The examiner was not able to obtain the CPA workpapers for 2000 and 2001. The Company had contracted Arthur Andersen LLP (“Andersen”) for those years. Andersen completed the 2000 audit and issued the report of independent public accountants and statutory financial statements as of December 31, 1999 and 2000 in April 2002. However, Andersen did not complete the 2001 audit. The Company has since engaged BDP Seidman LLP to conduct the 2001 and 2002 audit.

Allocation of Expenses

During the prior examination, Company management could not provide detailed worksheets to support the allocation of expense category to a particular expense group per Department Regulation 30. The Department has directed management to establish and maintain written documentation supporting the allocation each expense category to the major expense groups as required by Department Regulation 30. The Company submitted a Regulation 30 study for 1999. However, a review of the Underwriting and Investment Exhibit, Part 4 of the Company’s 2001 annual statement indicated that the Company did not allocate expenses in accordance with the 1999 study. The Company refused to perform an updated study for 2001. Therefore, it is again recommended that the Company perform an updated Regulation 30 study and allocate expenses in accordance with that study as directed by the Department.

Schedule P

A review of Schedule P indicated that the Company did not follow the annual statement instructions in allocating allocated loss adjustment expenses. In addition, the Company did not complete Schedule P Interrogatories.

It is recommended that the Company follow the annual statement instructions in preparing Schedule P and other schedules in all future statements.

Custodial Agreement

The Company could not locate the custodial agreement signed with Wachovia Bank.

It is recommended that the Company execute a new custodial agreement with Wachovia Bank. The terms of such agreement should comply with the guidelines set forth in Part 1-General, Section IV.H-Custodial or Safekeeping Agreements of the NAIC Financial Condition Examiners Handbook.

General Interrogatories

The Company failed to disclose securities pledged as collateral of \$2,250,000 on item 23.26 of the General Interrogatories.

It is again recommended that the Company exercise care in completing the general interrogatories of the annual statement and ensure proper disclosures are included in such section.

G. Significant Operating Ratios

The following ratios have been computed as of December 31, 2001, based upon the results of this examination:

Net premiums written to surplus as regarding policyholders	17%
Liabilities to liquid assets (cash and invested assets less investment in affiliates)	105%
*Premiums in course of collection to surplus as regards policyholders	41%
*Investment Yield	4%
*Change in Policyholders Surplus	(41)%
*Estimated Current Reserve Deficiency to Policyholders Surplus	34%

The above ratios denoted with an asterisk fall outside the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners. The results were due to adverse loss development, reduction in invested assets for payments of claims, decrease in premiums written and examination adjustments on real property and reinsurance recoverable.

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	\$10,806,062	309.21%
Other underwriting expenses incurred	(5,802,649)	(166.04)
Net underwriting loss	<u>(1,508,642)</u>	<u>(43.17)</u>
Premiums earned	<u>\$3,494,771</u>	<u>100.00%</u>

H. Abandoned Property

During the examination period, the Company only filed the abandoned property reports for 1998 and 1999. It is recommended that the Company escheat any unclaimed funds and submit them with the abandoned property reports to the Office of the State Comptroller in accordance with Section 1316 of the Abandoned Property Law.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as determined by this examination as of December 31, 2001 and as reported by the Company:

<u>Assets</u>	<u>Examination</u>		<u>Company</u>		Surplus Increase <u>(Decrease)</u>
	<u>Assets</u>	Assets Not <u>Admitted</u>	Net Admitted <u>Assets</u>	Net Admitted <u>Assets</u>	
Bonds	\$ 8,838,428	\$	\$ 8,838,428	\$ 8,838,428	\$
Real estate occupied by company	1,714,292	614,292	1,100,000	1,714,292	(614,292)
Real estate held for sale	57,418	17,418	40,000	57,418	(17,418)
Cash and short-term investments	2,886,202		2,886,202	2,712,702	173,500
Other invested assets	69,200		69,200	69,200	
Premiums and agents' balances in course of collection	1,844,966	158,546	1,686,420	1,686,420	
Premiums, agents' balances and installments booked but deferred and not yet due	473,734		473,734	473,734	
Reinsurance recoverables on loss and loss adjustment expense payments	1,434,170	56,907	1,377,263	1,434,170	(56,907)
EDP equipment and software	1,918		1,918	1,918	
Interest, dividends and real estate income due and accrued	133,250		133,250	133,250	
Receivable from parent, subsidiaries and affiliates	1,436,965	15,070	1,421,895	1,436,965	(15,070)
Equities and deposits in pools and associations	106,837		106,837	106,837	
Other assets nonadmitted	<u>44,847</u>	<u>44,847</u>	_____	_____	_____
Total Assets	<u>\$19,042,227</u>	<u>\$907,080</u>	<u>\$18,135,147</u>	<u>\$18,665,334</u>	<u>\$(530,187)</u>

<u>Liabilities</u>	<u>Examination</u>	<u>Company</u>	Surplus Increase <u>(Decrease)</u>
Losses	\$6,867,257	\$5,917,257	\$(950,000)
Reinsurance payable on paid losses and loss adjustment expenses	19,527	(153,973)	(173,500)
Loss adjustment expenses	3,893,267	3,893,267	
Commissions payable, contingent commissions and other similar charges	(14,068)	(14,068)	
Other expenses (excluding taxes, licenses and fees)	242,626	242,626	
Taxes, licenses and fees (excluding federal and foreign income taxes)	65,146	65,146	
Borrowed money and interest thereon	923,700	923,700	
Unearned premiums	349,537	349,537	
Ceded reinsurance premiums payable (net of ceding commissions)	925,159	925,159	
Provision for reinsurance	292,119	292,119	
Payable to parent, subsidiaries and affiliates	<u>121,764</u>	<u>121,764</u>	<u> </u>
 Total liabilities	 <u>\$13,686,034</u>	 <u>\$12,562,534</u>	 <u>\$(1,123,500)</u>
 <u>Surplus and other funds</u>			
Common capital stock	\$2,500,000	\$2,500,000	\$
Gross paid in and contributed surplus	6,105,466	6,105,466	
Unassigned funds (surplus)	<u>(4,156,353)</u>	<u>(2,502,666)</u>	<u>(1,653,687)</u>
Surplus as regards policyholders	<u>\$4,449,113</u>	<u>\$6,102,800</u>	<u>\$(1,653,687)</u>
 Total liabilities, surplus and other funds	 <u>\$18,135,147</u>	 <u>\$18,665,334</u>	

NOTE: The Internal Revenue Service has not completed the audit of tax returns covering tax years 1998 through 2001. 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 \$351,407 during the four-year examination period

January 1, 1998 through December 31, 2001, detailed as follows:

Premiums earned		\$3,494,771
Deductions:		
Losses incurred	\$4,250,894	
Loss adjustment expenses incurred	6,728,668	
Other underwriting expenses incurred	<u>(5,802,649)</u>	
Total underwriting deductions		<u>5,176,913</u>
Net underwriting gain or (loss)		\$(1,682,142)
 <u>Investment Income</u>		
Net investment income earned	\$4,086,572	
Net realized capital gain	<u>(81,365)</u>	
Net investment gain or (loss)		4,005,207
 <u>Other Income</u>		
Net gain or (loss) from agents' or premium balances charged off	\$(626,162)	
Finance and service charges not included in premiums	45,101	
Aggregate write-ins for miscellaneous income	<u>(9,901)</u>	
Total other income		<u>(590,962)</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$1,732,103
Federal and foreign income taxes incurred		<u>1,052,796</u>
Net Income		<u>\$679,307</u>

C. Capital and Surplus Account

Surplus as regards policyholders per report on examination as of December 31, 1997			\$4,460,521
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$679,307		
Change in nonadmitted assets		\$605,895	
Change in provision for reinsurance		215,485	
Aggregate write-ins for gains and losses in surplus	<u>130,665</u>	<u> </u>	
Total gains and losses	<u>\$809,972</u>	<u>\$821,380</u>	
Net increase (decrease) in surplus			<u>(11,408)</u>
Surplus as regards policyholders per report on examination as of December 31, 2001			<u>\$4,449,113</u>

4. REAL ESTATE OCCUPIED BY COMPANY

The examination admitted asset of \$1,100,000 is \$614,292 less than the \$1,714,292 reported by the Company in its December 31, 2001 filed annual statement.

The examination value of \$1.1 million is based on the Department's evaluation of an appraisal of the Company's home office property received on November 14, 2002. The examination is adjusting the property value in accordance with SSAP # 40.10 and # 40.11 of the NAIC Practices and Procedures Manual which state in part:

“Properties that the reporting entity has intent to sell or is required to sell shall be classified as properties held for sale and carried at the lower of depreciated cost or fair value less encumbrances and estimated costs to sell the property consistent with paragraph 16 of FAS 121.”

“The current fair value of real estate shall be determined on a property by property basis and shall be defined as the price that a property would bring in a competitive and open market under all conditions requisite to a fair sale. If the market quotes are unavailable, estimates of fair value shall be determined by an appraisal, which is based upon an evaluation of all relevant data about the market, consideration the following:

- a. A physical inspection of the premises;
- b. The present value of future cash flows generated by the property , or capitalization of stabilization net operating income;
- c. Current sales prices of similar properties with adjustments for differences in the properties;
- d. Costs to sell the property if the reporting entity does not have the similar intent or ability to hold the real estate as an investment; and
- e. Replacement costs of the improvements, less depreciation, plus the value of the land.

It is therefore recommended that the Company reclassify the captioned property as property held for sale and adjust the property value in accordance with SSAP # 40.11 of the NAIC Practices and Procedures Manual.

5. REAL ESTATE HELD FOR SALE

The examination admitted asset for the captioned item of \$40,000 is \$17,418 less than the \$57,418 reported by the Company in its December 31, 2001 filed annual statement. The Company acquired this property on December 20, 1996, in satisfaction of debt from a broker accordance with Section 1404(a)(5)(A)(iii) of the New York Insurance Law. Section 1404(a)(5)(B)(iii) of the New York Insurance Law requires that real property acquired pursuant Section 1404(a)(5)(A)(iii) of the New York Insurance Law, shall be disposed of within five years after the date of acquisition, unless the superintendent certifies that the interests of the insurers will suffer materially by the forced sales thereof and extends the time in such certificate.

The examination value of \$40,000 is based upon an offer received by the Company for this property.

It is recommended that the Company dispose of the captioned property in accordance with Section 1414(a)(5)(iii) of the New York Insurance Law. In addition, the Company should adjust the property value in accordance with SSAP # 40.11 of the NAIC Practices and Procedures Manual.

6. CASH AND SHORT TERM INVESTMENTS

The examination admitted asset of \$2,886,202 is \$173,500 more than the \$2,712,702 reported by the Company in its December 31, 2001 filed annual statement.

The Company booked a payment for reinsurance payable on paid losses twice in 2001. As the result, cash was understated and reinsurance payable was overstated. The examiner restated cash and reinsurance payable on paid loss as of December 31, 2001 to reflect the correct balances for these accounts.

7. **REINSURANCE RECOVERABLES ON LOSS AND LOSS ADJUSTMENT EXPENSE**
PAYMENTS

The examination admitted asset of \$1,377,263 is \$56,907 less than the \$1,434,170 reported by the Company. The examination determined that \$56,907 of the year-end reinsurance recoverables were deemed uncollectible and therefore non-admitted. The above balances were over-due beyond the payment periods set forth in the reinsurance contracts.

8. **RECEIVABLES FROM PARENT, SUBSIDIARIES AND AFFILIATES**

The examination admitted asset of \$1,421,895 is \$15,070 less than the \$1,436,965 reported by the Company in its December 31, 2001 filed annual statement.

The examination determined that \$15,070 of the year-end inter-company balances were deemed uncollectible and therefore non-admitted. The Company included amounts that were 90 days over-due in the 2001 year-end inter-company balances. It appears that the Company violated Circular Letter No. 15 (1975) which requires inter-company balances to be settled within 90 days and that any balances 90 days over-due be non-admitted.

It is recommended that the Company comply with Circular Letter No. 15 (1975), settle any inter-company balances within the 90 days limit and write-off any amounts beyond that limit.

9. LOSSES & LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$10,760,524 is \$950,000 more than the \$9,810,524 reported by the Company in its December 31, 2001 filed annual statement. The examination change is due to re-establishment of loss reserves for ceded reinsurance balances due from Reliance, an insurer in liquidation. The examination has determined that reinsurance recoverable from Reliance is uncollectible due to the insolvency of the insurers.

It is recommended that the Company account for ceded reinsurance balances in accordance with SSAP #62.56 which requires insurers to write off uncollectible reinsurance balances through the accounts, exhibits and schedules in which they were originally recorded.

The examination analysis of the loss and loss adjustment expense reserves was conducted in accordance with generally accepted actuarial principles and was based on statistical information contained in the Company's internal records and in its filed annual statements.

The Company is billed for a claim service fee from MDA, an affiliated claims adjuster. The Company records this claim service fee as loss adjustment expenses paid. The difference between gross service fee for the month and the current earnings based on the Company earning pattern is calculated as the deferred amount. This deferred amount is classified as Loss Adjustment Expenses Reserves – Adjusting and Other Unpaid Expenses. Thus, the amounts reflected by the Company as Loss Adjustment

Expenses paid or Loss Adjustment Expenses reserves do not reflect actual expenditures as required by Department Regulation No. 30.

10. 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's claims and complaints handling. No problem areas were encountered.

11. SUBSEQUENT EVENTS

Master Agreement between The Robert Plan Corp. and American International Group

On June 20, 2001, the New Jersey Department of Banking and Insurance ("New Jersey Department") placed Eagle Insurance Company ("Eagle") and its subsidiaries Newark Insurance Company and GSA Insurance Company under administrative supervision. Another subsidiary, National Consumer Insurance Company, was placed under administration supervision in June 1995. Eagle and its subsidiaries were ordered to cease writing new and renewal business by the New Jersey Department by a letter dated November 16, 2001. On July 31, 2001, this Department also recommended that Eagle cease writing all new and renewal business.

Due to the financial condition of Robert Plan Corp. (“Robert Plan”) and its subsidiaries, Robert Plan was not in compliance with certain loan covenants.

On January 1, 2002, Robert Plan and American International Group (“AIG”) entered into a multi-year agreement (“master agreement”). The New Jersey Department approved the master agreement effective February 1, 2002. This Master Agreement requires AIG to purchase \$150 million of surplus note(s) from Eagle and commits to making all scheduled debt and interest payments on the existing debt of the Robert Plan.

12. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained 24 recommendations as follows (page numbers refer to the prior report):

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
i. It is recommended that the Company adhere to all provisions of its by-laws, henceforth.	6
The Company has not complied with this recommendation. A similar comment is made in this report.	
ii. It is recommended that the Company adhere to the provisions of Section 712 of the New York Business Corporation Law, henceforth.	6-7
The Company has complied with this recommendation.	
B. <u>Reinsurance: Pooling Agreements</u>	
It is noted that settlements are not being made under the Pooling and Reinsurance Agreement between CIIC and CCIC because of the litigation and arbitration proceedings related to such agreement. Thus, it is recommended that in future financial statements filed with this Department, receivables from affiliates or former affiliates that are in dispute, be shown as not admitted assets, inasmuch as such receivables are not available for the payment of losses and claims, as required by Section 1301(a)(21) of the New York Insurance Law.	12
The Company has not complied with this recommendation. The case was settled in 2002. On September 30, 2002, the Company wrote off any remaining overdue receivable from Cooperative.	
C. <u>Holding Company System: Tax Allocation Agreement</u>	
It is recommended that in future financial statements filed with this Department, the Company indicate the source of any "Federal Income Tax Recoverable" shown, as required by the annual statement instructions.	14
The Company has complied with this recommendation.	

ITEMPAGE NO.D. Holding Company System: Regulation 52

It is recommended that the Company adhere to the reporting requirements of Regulation 52, Section 80-1.4 by furnishing all of the required information within 120 days following the end of each fiscal year. It is noted that a similar recommendation was included in the prior report on examination.

14-15

The Company has complied with this recommendation.

E. Holding Company System: Claims Service Agreements with MDA

- i. It is recommended that the “Claims Service Agreement,” covering 1994 and subsequent claims, with MDA be adhered to with regard to the billing of expenses, henceforth.

17-18

The Company has complied with this recommendation.

- ii. It is recommended that the Company and MDA enter into a written agreement regarding the expenses paid by MDA on behalf of Colonial Indemnity, which should include the terms of settlement. In addition, it is recommended that internal control procedures be implemented to ensure that Colonial Indemnity only reimburses MDA for expenses that are actually related to Colonial Indemnity in the future.

18

The Company has complied with this recommendation.

F. Holding Company System: Section 1505 of the New York Insurance Law Compliance

It is recommended that the Company follow the prior notice requirements of Article 15 of the New York Insurance Law, henceforth. It is noted that a similar recommendation was included in the three previous reports on examination.

19-20

The Company has not complied with this recommendation. A similar comment is made in this report.

G. Section 1221 Compliance

During the current period under examination, several officers and directors did not make the necessary filings as required by Section 1221 of the New York Insurance Law. In the course of this examination, the requirements of Section 1221 were brought to the attention of Company management. Subsequent, the required filings were made with this Department. It is noted that a similar comment was included in the two previous reports on examination.

21-22

ITEMPAGE NO.

The Company has complied with this recommendation

H. CPA Contracts and Reports

- i. It is recommended that the Company maintain a written contract with its independent certified public accountant, for each audit year, that complies with Department Regulation 118. A similar recommendation was included in the two previous reports on examination. 22

The Company has not complied with this recommendation. A similar comment is made in this report.

- ii. It is recommended that the Company adhere to Section 307(b) of the New York Insurance Law, henceforth and file its annual CPA report in accordance with the time frame prescribed by such section. 23

The Company has not complied with this recommendation. A similar comment is made in this report.

I. Allocation of Expenses

- Management is directed to establish and maintain written documentation supporting the allocation of each expense category to the major expense groups as required by Department Regulation 30. It is noted a similar recommendation was included in the previous report on examination. 23

The Company has not complied with this recommendation. A similar comment is made in this report.

J. Custodial Agreement Provisions

- It is recommended that the Company amend its custodial agreement with The Chase Manhattan Bank to include the provision, of the Department's guidelines for custodial agreements, related to Bankers' Blanket Bond coverage. 23

The Company has complied with this recommendation.

K. Schedule P

- i. It is recommended that the Company complete Interrogatory 8 of the Schedule P Interrogatories in accordance with the annual statement instructions, in future annual statements filed this Department. 24-25

The Company has not complied with this recommendation. A similar comment is made in this report.

<u>ITEM</u>		<u>PAGE NO.</u>
ii.	It is recommended that in future financial statements filed with this Department, the Company follow the instructions, set forth in the annual statement blank, for reporting unallocated loss adjustment expenses in Schedule P. The Company has not complied with this recommendation. A similar comment is made in this report.	25
L.	<u>Litigation</u> As noted in the previous report on examination, the Company is a party to litigation that is outside the normal course of doing an insurance business. The Company was a party to litigation that is outside the normal course of business during this examination. The case was settled in 2002.	26-27
M.	<u>Accounts and Records</u>	
i.	It is recommended that in future financial statements filed with this Department, the Company classify Advance Premiums in accordance with the annual statement instructions. The Company has complied with this recommendation.	28
ii.	It is recommended that the Company record all premiums due under its reinsurance contracts as ceded reinsurance balance payable, which offsets the asset, "Agents' Balance or Uncollected Premiums," in accordance with the annual statement instructions, henceforth. The Company has complied with this recommendation.	28
iii.	It is recommended that the Company not take admitted asset credit for checks that are returned for insufficient funds before the statement date or for the value of outstanding checks issued against a zero balance account in future financial statements filed with this Department. The Company has complied with this recommendation.	29
iv.	It is recommended that the Company reflect its equity in the "Fair Plan" up through the appropriate statement date in all future financial statements filed with this Department. The Company has complied with this recommendation.	29

<u>ITEM</u>		<u>PAGE NO.</u>
v.	It is recommended that the Company develop a written disaster/back-up and recovery plan in order to strengthen its electronic data processing department controls.	29
	The Company has complied with this recommendation.	
N.	<u>Section 310 Compliance</u>	
	It is recommended that the Company's board of directors and its officers set forth and implement a policy designed to ensure that the Company fully complies with the requirements of Section 310 of the New York Insurance Law, henceforth.	30
	The Company has complied with this recommendation	
O.	<u>Market Conduct Activities</u>	
i.	It is recommended that when sending out notices of termination of agents' or brokers' contracts or accounts, the Company ensure that all of the requirements of Department Regulation 90 are complied with, henceforth. It is noted that a similar recommendation was included in the prior report on examination.	37
	The Company has complied with this recommendation.	
ii.	It is recommended that the Company comply with all the requirements of Department Regulation 96, henceforth. It is noted that a similar recommendation was included in the prior report on examination.	37
	The Company has complied with this recommendation.	37

13. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
i. It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.	5
ii. It is recommended that the Company comply with Section 312 of the New York Insurance Law by furnishing to each member of the board a copy of the report on examination and retaining a statement from each board member that he or she has received and read such report.	6
iii. It is recommended that the board of directors meet four times per year as required by Article II, Section 2 of its by-laws.	6
iv. It is again recommended that the Company hold its stockholders' meetings on the date specified in Section 6 of its amended charter.	6
B. <u>Territory and Plan of Operation</u>	
It is recommended that the Company amend its Kentucky license to match its New York license in comply with Section 1102(b) of the New York Insurance Law.	7
C. <u>Reinsurance</u>	
It is recommended that the Company exercise greater care in preparing its annual statement and assure that Schedule F and all other schedules are reconciled.	9
D. <u>Holding Company System</u>	
<u>Schedule Y</u>	
It is recommended that the Company properly report its holding company structure in Schedule Y Part 1 and any inter-company transactions in Schedule Y Part 2.	10

ITEMPAGE NO.Policy Administration and Servicing Agreement

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|-----|--|----|
| i. | The Company has violated Section 1505(d)(3) of the New York Insurance Law by failing to file its revised policy administration servicing agreement with the Department on a timely basis. | 15 |
| ii. | It is also recommended that the Company comply with the filing requirements set for in Section 1505(d) of the New York Insurance Law and file all inter-company agreements with the Department on a timely basis. A similar recommendation was made in the previous report on examination. | 15 |

E. Accounts and RecordsCPA Contracts and Reports

- | | | |
|------|---|----|
| i. | It is recommended that the Company maintain a written contract with its independent certified public accountant that complies with record retention and other provisions set forth in Department Regulation 118 and 152. A similar recommendation was in the three previous reports on examination. | 16 |
| ii. | It is also recommended that the Company amend the contract with BDO Seldman LLP in order to comply with Regulation 118 and 152. | 16 |
| iii. | It is again recommended that the Company file its CPA report in accordance with the time frame prescribed by Section 307 of the New York Insurance Law. A similar recommendation was included in the previous three reports on examination. | 16 |
| iv. | The examiner was not able to obtain the CPA workpapers for 2000 and 2001. | 17 |

Allocation of Expenses

It is recommended that the Company perform an updated Regulation 30 study and allocate expenses in accordance with that study.	17
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Schedule P

It is recommended that the Company follow the annual statement instructions in preparing Schedule P and other schedules for all future statements.	17
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ITEMPAGE NO.Custodial Agreement

It is recommended that the Company execute a new custodial agreement with Wachovia Bank. The terms of such agreement should comply with the guidelines set forth in Part 1-General, Section IV.H-Custodial or Safekeeping Agreements of the NAIC Financial Condition Examiners Handbook. 18

General Interrogatories

It is again recommended that the Company exercise care in completing the general interrogatories of the annual statement and ensure proper disclosures are made in such section. 18

F. Significant Operating Ratios

The Company failed four IRIS Ratios in 2001. 18

G. Abandoned Property

It is recommended that the Company escheat any unclaimed funds and submit them with the abandoned property filings to the Office of the State Comptroller in accordance with Section 1316 of the New York Abandoned Property Law. 19

H. Real Estate Occupied by Company

It is recommended that the Company reclassify the captioned property as property held for sale and adjust the property value in accordance with SSAP #40.11 of the NAIC Practices and Procedures Manual. 25

I. Real Estate Held for Sale

It is recommended that the Company dispose of the captioned property in accordance with Section 1414(a)(5)(iii) of the New York Insurance Law. In addition, the Company should adjust the property value in accordance with SSAP # 40.11 of the NAIC Practices and Procedures Manual. 24

J. Receivables from Parent, Subsidiaries and Affiliates

It is recommended that the Company comply with Circular Letter No. 15 (1975), settle any inter-company balances within the 90 days limit and write-off any amounts beyond that limit. 27

ITEMPAGE NO.K. Loss and Loss Adjustment Expenses

It is recommended that the Company account for ceded reinsurance balances in accordance with SSAP #62.56 which requires insurers to write off uncollectible reinsurance balances through the accounts, exhibits and schedules in which they were originally recorded.

27

Appointment No. 21835

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:

Annie Lau

as proper person to examine into the affairs of the

COLONIAL INDEMNITY INSURANCE COMPANY

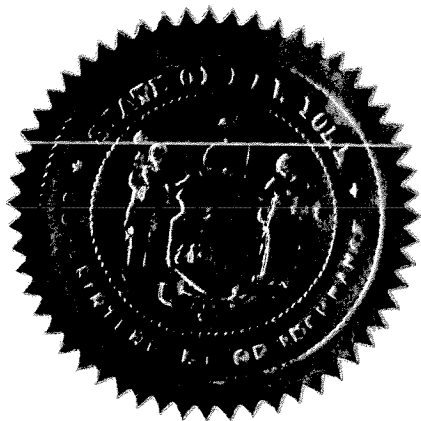
and to make a report to me in writing of the condition of the said


Company

with such other information as she 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 14th day of February, 2002





GREGORY V. SERIO
Superintendent of Insurance