

REPORT ON EXAMINATION

OF THE

PG INSURANCE COMPANY OF NEW YORK

AS OF

DECEMBER 31, 2001

DATE OF REPORT

MAY 27, 2004

EXAMINER

LARRY E. CROSS

## TABLE OF CONTENTS

<u>ITEM</u>	<u>PAGE NO.</u>
1. Scope of Examination	2
2. Description of the Company	3
A. Management	4
B. Territory and plan of operation	7
C. Reinsurance	9
D. Holding company system	16
E. Significant operating ratios	20
F. Abandoned Property Law	21
G. Accounts and records	21
H. Compliance with Section 310 of the New York Insurance Law	26
3. Financial Statements	28
A. Balance sheet	28
B. Underwriting and investment exhibit	30
4. Premiums, agents' balances and installments booked but deferred and not yet due	32
5. Funds held by or deposited with reinsured companies	32
6. Reinsurance recoverables on loss and loss adjustment expense payments	32
7. Federal income taxes recoverable	33
8. Losses and loss adjustment expenses	33
9. Reinsurance payable on paid losses and loss adjustment expenses	35
10. New York automobile insurance plan liability	35
11. Accounts payable	36
12. Market conduct activities	36
13. Conclusion	37
14. Compliance with prior report on examination	37
15. Summary of comments and recommendations	38
16. Appendix: Organization chart	



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

May 27, 2004

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 21974 dated December 9, 2002, attached hereto, I have made an examination into the condition and affairs of the PG Insurance Company of New York as of December 31, 2001, and submit the following report thereon.

The examination was conducted at the Company's administrative offices located at One Beacon Street, Boston, Massachusetts 02108.

Wherever the designations "the Company" or "PGICNY" appear in this report, they should be understood to indicate the PG Insurance Company of New York.

Wherever the designation "HIC" appears in this report, it should be understood to mean the Homeland Insurance Company of New York.

Wherever the designation “GAC” appears in this report, it should be understood to mean the General Assurance Company.

Wherever the designation “OneBeacon” appears in this report, it should be understood to mean OneBeacon Insurance Company.

Wherever the term “OneBeacon Pool” appears in this report, it should be understood to mean the OneBeacon Insurance Group Pool, a pool comprised of thirteen affiliated insurance companies whose combined underwriting results are shared among the members. The pool participants are set forth in item 2C herein. Wherever the term “Department” appears herein without qualification, it should be understood to mean the New York Insurance Department.

As a result of this examination, the Company’s surplus as regard policyholders has been decreased by \$7,676,720 with surplus as regards policyholders as being determined to be \$30,117,102 as of December 31, 2001. Since the Company is licensed to write multiple reinsurance pursuant to Section 4102(c) of the New York Insurance Law, the Company is required to maintain a minimum surplus of \$35,000,000. Thus, the Company’s surplus as regards policyholders as determined by this examination is impaired in the amount of \$4,882,898.

It is noted that the surplus as regards policyholders as of December 31, 2002, December 31, 2003 and March 31, 2004, as reported to this Department in the filed statements, is in excess of the required \$35,000,000. The Company’s subsequent reported surplus as regards policyholders reflects increases to the loss and loss adjustment expense reserves for accident years 2001 and prior, as well as the establishment of the New York automobile insurance plan liability.

## **1. SCOPE OF EXAMINATION**

The previous examination was conducted as of December 31, 1996. This examination covered the five-year period from January 1, 1997 through December 31, 2001. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination comprised a complete verification of assets and liabilities as of December 31, 2001, a review of income and disbursements deemed necessary to accomplish such verification, and utilized, to the extent considered appropriate, work performed by the Company's independent certified public accountants. A review or audit was also made of the following items as called for in the Financial Condition Examiners Handbook of the National Association of Insurance Commissioners ("NAIC"):

- History of the Company
- Management and control
- Corporate records
- Holding company system
- Fidelity bond and other insurance
- Territory and plan of operation
- Growth of the Company
- Business in force by state
- Significant operating ratios
- Reinsurance
- Accounts and records
- Financial statements
- Losses and loss adjustment expenses
- Market conduct activities

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination. This report on examination is confined to financial statements and comments on those matters, which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

## 2. DESCRIPTION OF THE COMPANY

PGICNY is a stock insurance company incorporated under the laws of the State of New York on May 11, 1988. The Company was licensed on July 19, 1988, and commenced business on October 1, 1988. At the time the Company was formed, it was wholly-owned by General Accident Corporation of America, and ultimately owned by General Accident Plc, a Scottish non-insurer corporation.

On June 2, 1998, Commercial Union Plc acquired General Accident Plc and formed CGU Plc, the new ultimate parent. At that time, the name of General Accident Corporation of America was changed to CGU Insurance Company.

On June 1, 2001, the White Mountains Insurance Group, Ltd., a Bermuda holding company, acquired CGU Plc. At that time, the name of CGU Insurance Company was changed to OneBeacon Insurance Company. Thus, as of December 31, 2001, the Company is wholly-owned by OneBeacon Insurance Company, and is ultimately owned by White Mountains Insurance Group, Ltd.

On August 2, 1999, the Company's then sole shareholder, CGU Insurance Company, amended the Company's charter to change the name of the Company from PG Insurance Company of New York to CGU Insurance Company of New York. On September 13, 2001, the Company's sole shareholder, OneBeacon Insurance Company, again amended the Company's charter to change the name of the Company back to its original name of PG Insurance Company of New York.

Capital paid in is \$1,000,000 consisting of 100,000 shares of \$10 par value per share common stock. Capital paid in has not changed since December 31, 1996.

Gross paid in and contributed surplus was \$33,419,873. Gross paid in and contributed surplus increased by \$20,825,000 during the examination period, as follows:

<u>Year</u>	<u>Description</u>	<u>Amount</u>
12/31/96	Beginning gross paid in and contributed surplus	\$12,594,873
2001	Surplus paid in during the year	<u>20,825,000</u>
12/31/01	Ending gross paid and contributed surplus	\$33,419,873

The Department's review of the Company's December 31, 2000 filed annual statement indicated that the Company's reported surplus to policyholders was \$23,735,396. Since the Company is licensed to write reinsurance pursuant to Section 4102 (c) of the New York Insurance Law, it is required to maintain a minimum surplus to policyholders of \$35,000,000. On April 18, 2001 the Department notified the Company that its reported surplus was impaired in the amount of \$11,264,604. The Company, as a result of this notice, received a surplus contribution of \$20,825,000 from its parent, OneBeacon Insurance Company to remedy the impairment.

During the period covered by this examination, the Company declared and paid the following dividends to its sole shareholder:

<u>Date Declared and Paid</u>	<u>Amount</u>
February 7, 1997	\$3,400,000
February 9, 1998	\$3,600,000

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 thirteen nor more than nineteen members. The board of directors met four times during each calendar year. At December 31, 2001, the board of directors was comprised of the following twelve members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Raymond Joseph Rene Barrette Hanover, NH	Chairman, OneBeacon Insurance Company
Vincent Anthony Brazauskas North Easton, MA	Senior Vice President, OneBeacon Insurance Company
John Paul Cavoores Highlands, NJ	Senior Vice President, OneBeacon Insurance Company
Morgan Wesley Davis Roseville, CA	Senior Vice President, OneBeacon Insurance Company
Larry Albert Haefner Boston, MA	Senior Vice President & Actuary, OneBeacon Insurance Company
Richard Allen Jordan Amherst, NH	Senior Vice President, OneBeacon Insurance Company
James Robert Mummey Williamsville, NY	Vice President – Commercial Lines, OneBeacon Insurance Company
Alexander Francis Oristian Williamsville, NY	President, PG Insurance Company of New York
James Joseph Ritchie Newtown, PA	Senior Vice President & Chief Financial Officer, OneBeacon Insurance Company
Bruce Wesley Sanderson Clifton Park, NY	Vice President – Branch Manager, OneBeacon Insurance Company
Roger Milgram Singer Belmont, MA	Senior Vice President & General Counsel, OneBeacon Insurance Company
John Arthur Weber Medfield, MA	Senior Vice President & Chief Investment Officer, OneBeacon Insurance Company

As noted above, the Company only had twelve members on its board of directors as of December 31, 2001 due to resignation of board member Richard Stephen Banas on December 21, 2001. On that same date, the remaining members of the board elected William John Tabinsky to replace Mr. Banas, to be effective January 7, 2002.

The Company's charter and by-laws require that the Company's board of directors shall consist of not less than thirteen directors. The Company was not in compliance with its own charter and by-laws as to the number of directors on the board. It is recommended that the Company adhere to the provisions of its charter and by-laws and maintain the minimum number of directors on its board at all times.

The minutes of all meetings of the board of directors' held during the examination period were reviewed. All meetings were well attended with a quorum in attendance at each meeting. However, three directors failed to attend at least one-half of the meetings covered by this examination period. These directors were part of former management and have since resigned. All of the current directors had attendance records that were greater than fifty percent of the eligible meetings held.

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

<u>Name</u>	<u>Title</u>
Raymond Joseph Rene Barrette	Chairman of the Board
Alexander Francis Oristian	President
Dennis Robert Smith	Secretary
Richard Charles Hirtle	Treasurer
Stuart Noel Lerwick	Chief Actuary
Vincent Anthony Brazauskas	Senior Vice President
Morgan Wesley Davis	Senior Vice President
Larry Albert Haefner	Senior Vice President & Actuary
Richard Allen Jordan	Senior Vice President
James Joseph Ritchie	Senior Vice President & Chief Financial Officer
Roger Milgram Singer	Senior Vice President & General Counsel
John Arthur Weber	Senior Vice President & Chief Investment Officer

B. Territory and Plan of Operation

As of December 31, 2001, the Company was licensed to write business in New York only.

The following schedule shows the direct premiums written by the Company for the period under examination:

<u>Year</u>	<u>Total</u>
1997	\$163,759,179
1998	143,308,461
1999	135,990,783
2000	156,132,868
2001	<u>116,794,335</u>
Total	<u>\$715,985,626</u>

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>Kind of Insurance</u>
3	Accident & health
4	Fire
5	Miscellaneous property damage
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
10	Elevator
11	Animal
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
16	Fidelity and surety
17	Credit
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity
26	Gap

The Company is also empowered to transact such workers' compensation business 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 803, 69th Congress, as amended; USC Section 901 et seq. as amended) and as authorized by New York Insurance Law, Section 4102 (c), insurance of every kind or description outside of the United States and reinsurance of every kind or description.

On December 4, 2000, the Company's board of directors and its sole shareholder amended the Company's charter to add to the kinds of insurance that the Company transacts to include "gap insurance". Gap insurance is defined as being insurance covering the gap amount which is payable upon the total loss of personal property, which is subject of a lease or loan or other credit transaction occasioned by its theft or physical damage.

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 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$35,000,000.

PGICNY and its two New York domiciled affiliates continue the practice of their respective nationally licensed affiliated counterparts in the OneBeacon Pool, whereby each of the three New York companies concentrates on a particular segment of the New York market, differentiated in terms of rate levels: standard, preferred and special super-preferred. PGICNY is the pool's instrument for the preferred market.

OneBeacon Insurance Group markets its products through an agency force of approximately 2,200 independent agents and brokers with particularly strong representation in suburban and rural territories.

Products are marketed in the Northeast through approximately 1,100 independent agents. The Group's core regions are comprised of the New England states, New York and New Jersey. During the period covered by this examination, the Company wrote business solely in New York State

C. Reinsurance

Intercompany Reinsurance and Pooling Agreement

PGICNY, together with six of its affiliates, executed an intercompany reinsurance and pooling agreement on June 20, 1988, to take effect October 1, 1988. Two of PGICNY's pooling affiliates are New York companies that were also organized in 1988. The other four have longer corporate histories and have been associated in prior pooling arrangements. The 1988 intercompany reinsurance and pooling agreement traces its origins to 1951, when the Department approved the formation of the OneBeacon Pool (named the GA Pool until 1998, then renamed the CGU Pool until it was renamed the OneBeacon Pool in 2001). Until the end of 1981, the GA Pool was led by the United States Branch of General Accident Fire and Life Assurance Corporation, a United Kingdom insurer that had entered the United States through New York.

Effective January 1, 2001, the Company and twelve of its affiliates entered into an amended and restated reinsurance agreement ("the Pooling Agreement"). The intent of the OneBeacon Pool has been for OneBeacon Insurance Company ("OneBeacon"), a Pennsylvania domestic insurer, to assume 100% of the gross business of the other pool members. The total gross business of OneBeacon and other participants is combined. Reinsurance of the pool is arranged by OneBeacon. The pool's retention after reinsurance is shared through retrocession from OneBeacon to the other pool members. The Company shares in any loss that may result from uncollectible reinsurance that was placed for the benefit of the pool. As of the date of this examination, the Company's share of the intercompany pooling agreement was 1.50%.

Schedule F of the annual statement shows reinsurance ceded only to OneBeacon and reinsurance assumed from OneBeacon is reported net of reinsurance ceded for the benefit of the entire pool. Thus, it was concluded that the Schedule F data contained in the Company's annual statements filed for the years within the examination period appeared to accurately reflect the reported reinsurance transactions.

The participants in the OneBeacon Pool (current names) and their percentage shares from January 1, 1982, to December 31, 2001, were:

<u>Company (Domicile)</u>	<u>1/1/82</u>	<u>10/1/88</u>	<u>1/1/92</u>	<u>1/1/96</u>	<u>1/1/99</u>	<u>1/1/01</u>
OneBeacon Insurance Company (PA)	77.00%	66.50%	60.74%	50.74%	50.00%	54.00%
Camden Fire Insurance Association (NJ)	13.00	13.00	13.00	17.00	4.00	7.00
Pennsylvania General Insurance Co. (PA)	9.00	9.00	9.00	9.00	6.50	4.50
Potomac Insurance Co. of Illinois (IL)	1.00	1.00	1.00	1.50	0.50	0.50
Homeland Insurance Co. of New York (NY)		8.12	8.12	11.99	6.50	6.50
PG Insurance Co. of New York (NY)		1.89	1.89	2.79	1.50	1.50
General Assurance Company (NY)		0.49	0.49	0.72	0.60	0.60
Tri-State Insurance Company (OK)			4.32	4.32		
Farmers & Merchants Insurance Co. (OK)			0.86	0.86		
Midwestern Insurance Company (OK)			0.58	0.58		
Potomac Insurance Company (PA)				0.50		
OneBeacon America Ins. Co. (MA)					18.00	14.30
American Employers' Ins. Co. (MA)					5.00	4.20
The Northern Assurance Co. of America (MA)					5.00	5.00
The Employers' Fire Ins. Co. (MA)					2.00	1.50
OneBeacon Midwest Ins. Co. (WI)					0.30	0.30
American Central Insurance Co. (MO)					<u>0.10</u>	<u>0.10</u>
Totals	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

PGICNY has no employees or facilities of its own. All services necessary for the conduct of the Company's business are performed by or through the pool leader, OneBeacon Insurance Company, subject to the ultimate direction and control of the Company's board of directors. The pooling agreement provides that all expenses incurred in the conduct of the pool are to be considered joint expenses of the participants. Expenses are charged to each participant according to its respective pooling participation.

The pooling agreement in its current form has been approved by the New York Insurance Department on July 31, 2001 and contains an insolvency clause conforming to the requirements of Section 1308(a) of the New York Insurance Law. The examiner reviewed all ceded reinsurance contracts in effect at December 31, 2001. The contracts all contained the required standard clauses including insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

The following schedule compares the OneBeacon Pool's current reinsurance program with that as of the prior examination date:

<u>Type of Treaty</u>	<u>December 31, 1996 Cession</u>	<u>December 31, 2001 Cession</u>
<u>Property Per Risk Excess</u>		
First Layer	\$3,000,000 excess of \$2,000,000 per risk, each loss subject to a maximum recovery of \$9,000,000 (100% authorized)	\$7,000,000 excess of \$3,000,000 each risk each loss occurrence, subject to a maximum recovery occurrence limit for CAT perils of \$21,000,000 (95% authorized).
Second Layer	\$5,000,000 excess of \$5,000,000 per risk, each loss subject to a maximum recovery of \$10,000,000 (100% authorized)	\$5,000,000 excess of \$10,000,000 each risk each loss occurrence, subject to a maximum recovery occurrence limit for CAT perils of \$15,000,000 (94% authorized).
Third Layer	\$15,000,000 excess of \$10,000,000 per risk, each loss subject to a maximum recovery of \$30,000,000 (100% authorized)	\$10,000,000 excess of \$15,000,000 each risk each loss occurrence, subject to a maximum recovery occurrence limit for CAT perils of \$30,000,000 (95.5% authorized).
Fourth Layer		\$25,000,000 excess of \$25,000,000 each risk each loss occurrence, subject to a maximum recovery occurrence limit for CAT perils of \$50,000,000 (95% authorized).

<u>Type of Treaty</u>	<u>December 31, 1996 Cession</u>	<u>December 31, 2001 Cession</u>
Facultative		\$75,000,000 excess of \$50,000,000 each risk each loss occurrence (100% authorized).
<u>Property Catastrophe Excess – One Year Covers</u>		
First Layer (all states)	\$50,000,000 excess of \$75,000,000 each and every loss occurrence (100% authorized)	65% of \$75,000,000 excess of \$125,000,000 each and every loss occurrence (74.2% authorized).
Second Layer (all states)	95% of \$75,000,000 excess of \$125,000,000 each and every loss occurrence (100% authorized)	65% of \$75,000,000 excess of \$200,000,000 each and every loss occurrence (75% authorized).
Third Layer (all states)	95% of \$75,000,000 excess of \$200,000,000 each and every loss occurrence (100% authorized)	68% of \$100,000,000 excess of \$275,000,000 each and every loss occurrence (74.7% authorized).
Fourth Layer (all states)	95% of \$100,000,000 excess of \$275,000,000 each and every loss occurrence (100% authorized)	68% of \$100,000,000 excess of \$375,000,000 each and every loss occurrence (75.5% authorized).
Fifth Layer (Northeast only)		63% of \$175,000,000 excess of \$475,000,000 each and every loss occurrence (71.6% authorized).
Sixth Layer (Northeast only) [19 months coverage]		95% of \$100,000,000 excess of \$650,000,000 each and every loss occurrence (83.1% authorized).
Facultative	Automatic Property Facultative Agreement for \$25,000,000 in excess of \$25,000,000 [for the bonus broker, inland marine and national accounts programs] (100% authorized)	
<u>Property Catastrophe Excess – Three Year Covers</u>		
First Layer (all states)		30% of \$50,000,000 excess of \$125,000,000 each and every loss occurrence (13.3% authorized).
Second Layer (all states)		30% of \$75,000,000 excess of \$175,000,000 each and every loss occurrence (13.3% authorized).

<u>Type of Treaty</u>	<u>December 31, 1996 Cession</u>	<u>December 31, 2001 Cession</u>
Third Layer (all states except Florida and California)		30% of \$100,000,000 excess of \$250,000,000 each and every loss occurrence (13.3% authorized).
Fourth Layer (all states except Florida and California)		27% of \$125,000,000 excess of \$350,000,000 each and every loss occurrence (3.7% authorized).
Fifth Layer (Northeast only)		32% of \$175,000,000 excess of \$475,000,000 each and every loss occurrence (0% authorized).
<u>Casualty Catastrophe Excess</u>		
First Layer	\$3,500,000 excess of \$2,500,000 each and every loss occurrence (100% authorized)	\$7,500,000 excess of \$2,500,000 each and every loss occurrence (100% authorized).
Second Layer	\$4,000,000 excess of \$6,000,000 each and every loss occurrence (100% authorized)	\$10,000,000 excess of \$10,000,000 each and every loss occurrence (100% authorized).
Third Layer	\$10,000,000 excess of \$10,000,000 each and every loss occurrence (100% authorized)	\$20,000,000 excess of \$20,000,000 each and every loss occurrence (100% authorized).
Facultative	Automatic Casualty Facultative Agreement for umbrella policies, \$5,000,000 excess of \$5,000,000 (100% authorized)	Automatic Casualty Facultative Agreement for umbrella policies, \$15,000,000 excess of \$10,000,000 (100% authorized).
<u>Umbrella Excess of Loss</u>		
		100% of \$15,000,000 each loss, each policy, excess of \$10,000,000 each loss, each policy.
<u>Ocean/Inland Marine Excess of Loss</u>		
First Layer		100% of \$4,400,000 excess \$600,000 each and every loss and/or series of losses arising out of one occurrence.
Second Layer		100% of \$5,000,000 excess \$5,000,000 each and every loss and/or series of losses arising out of one occurrence.

<u>Type of Treaty</u>	<u>December 31, 1996 Cession</u>	December 31, 2001 Cession
Third Layer		100% of \$10,000,000 excess \$10,000,000 each and every loss and/or series of losses arising out of one occurrence.
Fourth Layer		100% of \$25,000,000 excess \$20,000,000 each and every loss and/or series of losses arising out of one occurrence.
<u>Designated Zones Homeowners Property Quota Share</u> (Covers New Jersey, New York, Connecticut, Massachusetts and Rhode Island)		30% as respects "Coastal" counties and 20% "Inland" counties up to a maximum liability of \$300,000 from any one risk (being 30% of a maximum liability of \$1,000,000).

Effective June 1, 2001, the OneBeacon Insurance Group, of which the Company is a member, entered into a reinsurance agreement with an affiliate, Potomac Insurance Company. The agreement provides the group with significant reinsurance protection against unanticipated increases in recorded reserves for losses and loss adjustment expenses associated with asbestos, environmental and certain other latent exposures, as well as excess of loss reinsurance protection against adverse development on accident year 2000 and prior losses. While the agreement was retrospective in nature, it did not result in a gain to surplus at the inception of the agreement. Thus, the agreement qualifies for prospective reinsurance accounting treatment under SSAP 62. Effective June 1, 2001, Potomac Insurance Company retroceded this business to National Indemnity Company. Also, effective June 1, 2001, the Group entered into an agreement of reinsurance with affiliate Potomac Insurance Company (who in turn retroceded the business to General Re Corporation) providing significant excess of loss reinsurance protection against adverse development on accident year 2000 and prior losses, covering substantially all classes of non-discontinued business. This agreement also qualifies for prospective reinsurance accounting treatment.

On October 31, 2001, OneBeacon Insurance Group (consisting of OneBeacon Corporation and its subsidiaries), executed a definitive renewal rights agreement with Liberty Mutual Insurance Group (“Liberty Mutual”). The agreement calls for Liberty Mutual to assume control of the infrastructure, employees and future underwriting results for all personal and commercial lines business previously written by the OneBeacon through agents in forty-two states and the District of Columbia. As a result of the agreement, OneBeacon’s remaining operations will be focused on New England, New Jersey, New York and selected specialty businesses. Pursuant to the agreement, effective November 1, 2001, Liberty Mutual assumed responsibility for the underwriting results of an estimated \$1.5 billion of annual commercial and personal lines premium written in the affected regions. Under the terms of the agreement, OneBeacon will reinsure from Liberty Mutual approximately 67% of the underwriting results on a quota share basis generated by the renewal of policies subject to the agreement during the first twelve months. The quota share will reduce to approximately 33% in the second year of the agreement and finally to 0% in the third year.

#### Unauthorized Reinsurance

The Company’s sole reinsurer is OneBeacon Insurance Company, an authorized insurer. Thus, there are no trust agreements and/or letters of credit obtained by the Company in order to take credit for its ceded reinsurance.

#### Reinsurance Intermediaries

The Company, through its participation in the OneBeacon Pool, indirectly utilizes the services of two reinsurance intermediaries that were properly licensed in the State of New York. The OneBeacon Pool, however, was unable to provide copies of written agreements entered into with its reinsurance intermediaries. The OneBeacon Pool did subsequently provide a copy of a reinsurance intermediary authorization agreement between Willis Re., Inc. and OneBeacon Insurance Company, the lead company

in the OneBeacon Pool, however, the agreement was executed in December 2002, nearly one year after the examination date. The Company, through its participation in the OneBeacon Pool, is not in compliance with Department Regulation 98 in light of the fact that the agreement that was executed was after the effective date of the agreement. It is recommended that the Company ensure that the lead company execute formal written authorizations with its reinsurance intermediaries in order to comply with Department Regulation 98. It is also recommended that the Company and/or the OneBeacon Pool, implement the necessary internal controls to ensure that the written authorizations entered into between the Company and its reinsurance intermediaries are available for review upon request.

D. Holding Company System

PGICNY is a controlled insurer pursuant to the provisions of Section 1501 of the New York Insurance Law. The Company is a member of the White Mountains Insurance Group, Ltd. (“WMIG”), a Bermuda holding company.

At December 31, 2001, 100% of the outstanding shares of the Company were owned by OneBeacon Insurance Company, a Pennsylvania corporation, which is ultimately controlled by WMIG. Its principal subsidiaries are insurance companies which write property, casualty, accident and health insurance worldwide. The majority of its business is property and casualty insurance written in the United Kingdom, the United States and Canada.

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, Section 1503 of the New York Insurance Law and Department Regulation 52.

On June 1, 2001, White Mountains Insurance Group, Ltd. acquired CGU Insurance Company from CGNU Plc. CGU Insurance Company was immediately renamed OneBeacon Insurance Company.

This acquisition was approved by the states of domicile of the CGU Group United States companies, including New York.

The organizational structure below depicts the insurance holding company system as of December 31, 2001 as relates to the Company. The U.S. State or country of incorporation/domicile and the ownership percentage of the downstream affiliate are displayed (1).

Franklin Mutual Advisors LLC, a mutual fund company, 14.2% (2)

John J. Byrne, an individual, 13.9% (3)

White Mountains Insurance Group, Ltd., Bermuda, 100%

White Mountains Holdings SRL, Barbados, 100%

WM Asset Management Ltd., Barbados, 100%

WM Bridgetown Ltd., Barbados, 100%

WM Enterprises Ltd., Barbados, 100%

Fund American Enterprises Holdings, Inc., Delaware, 100%

Fund American Companies, Inc., Delaware, 100%

OneBeacon Insurance Group LLC, Delaware, 100%

OneBeacon Insurance Company, Pennsylvania, 100%

Homeland Insurance Company of New York, New York

PG Insurance Company of New York, New York

General Assurance Company, New York

- 1) Berkshire Hathaway Inc. (Berkshire Hathaway) holds warrants to purchase 1,714,285 common shares of WMIG (8,264,861 common shares issued and outstanding at December 31, 2001). The warrants would represent 17.2% of the common shares of WMIG on a fully diluted basis if fully exercised.
- 2) Franklin Mutual Advisors LLC (Franklin Mutual) currently controls 1,177,271 common shares of WMIG, which constitutes approximately 14.2% of the WMIG common shares that are issued and outstanding at December 31, 2001, through investment management agreements with various mutual funds. Franklin Mutual will control approximately 11.8% of the outstanding shares of WMIG on a fully diluted basis if Berkshire Hathaway fully exercises its WMIG warrants described in (1) above.

- 3) John J. Byrne currently owns 1,150,932 common shares of WMIG, which constitutes approximately 13.9% of the WMIG common shares that are issued and outstanding at December 31, 2001. Mr. Byrne will own approximately 11.5% of the outstanding shares of WMIG on a fully diluted basis if Berkshire Hathaway fully exercises its WMIG warrants described in (1) above.
- 4) An entire organization chart for the WMIG holding company system is attached to this report on examination as an appendix.

The WMIG by-laws provide that the voting rights of any WMIG shareholder with respect to the election of WMIG directors are limited to 9.9%. On October 24, 2000, OneBeacon filed with the Pennsylvania Department of Insurance a disclaimer of control with respect to the ownership of WMIG common shares by Mr. Byrne, Berkshire Hathaway and Franklin Mutual Advisors LLC ("Franklin Mutual"). By letter dated January 10, 2001, the Pennsylvania Department of Insurance provided no objections to the disclaimers of control provided for Berkshire Hathaway and Franklin Mutual. However, the Pennsylvania Department of Insurance recommended that Mr. Byrne's disclaimer of control filing be withdrawn. The New York Insurance Department also considers Mr. Byrne to be the ultimate controlling person of WMIG

PGICNY has no employees or facilities of its own. All services necessary for the conduct of the Company's business are provided for in the amended and restated reinsurance pooling agreement (as described in Section 2C herein) and performed by or through the pool leader, OneBeacon Insurance Company, subject to the ultimate direction and control of the Company's board of directors. All expenses incurred in the conduct of the Company's operations are considered joint expenses of the thirteen pool participants and are charged to each pool participant using the same percentage as is used for the pool distribution of premiums and losses.

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

(1) Intercompany Investment Management Agreement

Effective July 1, 1999, PGICNY is a party to an investment management agreement with OneBeacon Asset Management, Inc. (“OBAM”), an affiliated company formerly known as CGU Asset Management, Inc. The agreement provides for OBAM to provide investment research and advice, including the execution of orders for the purchase and sale of securities. The fee for these services is paid quarterly and is equal to a percentage of the average market value of the investment portfolio during the preceding calendar quarter. This agreement was filed with the Department on June 8, 1999.

On July 1, 2002, the Company replaced the above agreement with a similar investment management agreement with White Mountains Advisors, LLC, formerly known as OneBeacon Asset Management, Inc. The new agreement provided for a manager’s compensation to be based upon a graduated level of total assets managed, with the amount of the fee decreasing as the amount of the assets increased. This agreement was filed with the Department on May 30, 2002 as part of the Company’s prior notice of a transaction (Form D) filing pursuant to Section 1505 (d)(3) of the New York Insurance Law.

(2) Intercompany Tax Allocation Agreement.

Effective June 2, 2001, the Company became a party to a Federal income tax sharing agreement with Fund American Enterprise Holdings, Inc. and its subsidiaries, which form a consolidated group. This tax allocation agreement, dated December 31, 2001, provides that in any year or part thereof that the parties file consolidated federal income tax returns, a computation shall be made on or before the date provided by law for the payment of any federal income tax or estimated tax of the amount of income taxes or estimated tax refund to which each party would have to make or to which such party would be entitled if it filed at that time a return declaration or refund claims as a separate corporation and had not at the time been a member of the consolidated group. This agreement was filed with the Department on August 14, 2001.

While the intercompany tax allocation agreement provided for the establishment of a separate tax escrow account for the amount by which the Company's tax payment for any year to Fund American Enterprise Holdings, Inc. exceeded the tax payment made by the consolidated group to the United States Treasury for such year, the Company and Fund American Enterprises Holdings, Inc. did not establish the required escrow account. Notwithstanding that there was no obligation to maintain any balance in the account as of the examination date, the Company and Fund American Enterprise Holdings, Inc., established the required escrow account pursuant to the tax allocation agreement at the recommendation of the examiners.

E. Significant Operating Ratios

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

Net premiums written in 2001 to surplus as regards policyholders	0.93 to 1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	84.42%
Premiums in course of collection to surplus as regards policyholders	2.47%

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:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$217,735,629	87.07%
Other underwriting expenses	\$81,619,504	32.64

Net underwriting gain/(loss)	<u>(49,291,695)</u>	<u>(19.71)</u>
Premiums Earned	<u>\$250,063,438</u>	<u>100.00%</u>

F. Abandoned Property Law

The Company is in compliance with Section 1316 of the New York Abandoned Property Law which requires that certain unclaimed insurance proceeds be reported to the State of New York by April 1st of each year.

G. Accounts and Records

Custody Agreement

The Company entered into a custody agreement with Mellon Trust of New York (“Mellon Trust – NY”) effective October 1, 1999. Mellon Trust-NY is responsible for the safekeeping of the Company’s investment portfolio holdings and collecting all dividend, interest and principal payments.

It was noted that the custodial agreement between Mellon Trust of New York and the Company contains some but not all of the proper controls and safeguards as mandated by the Part 1, Section IV of the NAIC Financial Condition Examiners Handbook. It is recommended that the custodial agreement between Mellon Trust of New York and the Company be amended to contain all of the proper controls and safeguards as mandated by Part 1, Section IV of the NAIC Financial Condition Examiners Handbook.

Subsequent to the date of the examination, and, effective April 27, 2004, the Company entered into an amended and restated custody agreement with Mellon Trust of New York. This agreement contains the proper controls and safeguards.

Securities Lending Authorization Agreement

OneBeacon and the Company entered into a securities lending authorization agreement with Mellon Bank, NA. The agreement specifies that collateral shall have a market value of not less than

102% of the market value of the loaned securities as of the loan delivery date. Forms of collateral are cash, securities issued or guaranteed by the United States government or its agencies, G-7 sovereign debt, and irrevocable letters of credit issued by a person other than the borrower or an affiliate of the borrower. Mellon Bank, NA in Pittsburgh, PA holds all collateral. The total market value of securities on loan at December 31, 2001, was \$33,824,559, with corresponding collateral valued at \$34,319,743. The total market value of loaned securities as of the delivery date was \$31,124,848. This agreement contains a provision that the agreement shall be construed in accordance with, and the rights of the parties are to be governed by, the laws of the Commonwealth of Pennsylvania. It is recommended that the Company amend the agreement to have the agreement to be construed in accordance with the laws of the State of New York.

Subsequent to the examination date, effective as of May 13, 2004, the Company and Mellon Bank, N.A. executed an amendment to the securities lending authorization changing the governing law to the laws of the State of New York.

An addendum on the final page of the 2001 annual statement for General Interrogatory 23.31 provides detail on the loaned securities as of December 31, 2001. However, this addendum was not referenced in the General Interrogatories on page 18 of the 2001 annual statement. Furthermore, the Company did not comply with the NAIC Annual Statement Instructions – Property & Casualty in that the Company did not identify in Schedule D of its 2001 and 2002 annual statements those assets that were not under the exclusive control of the Company. It is recommended that the Company comply with the instructions to the annual statement by identifying in its Schedule D of the annual statement those assets that were not under the exclusive control of the Company.

It is noted that the Company properly identified those assets that were not under the exclusive control of the Company in its 2003 annual statement.

#### Proper Classification of Short-term Investments

It was noted that the Company reported certain money market funds as cash at Schedule E - Part 1 in the 2001 annual statement when the proper classification according to the Statement of Statutory Accounting Principles (“SSAP”) 2, paragraph 11 and the instructions in the NAIC Securities Valuation Office (“SVO”) Purposes and Procedures Manual, Part 4, Section 6(d), Part 11, Sections 2(a) and 2(b) is as short-term investments on Schedule DA - Part 1. The following funds are classified as short-term investments under Part 11, Section 2 of the SVO instructions:

U.S. direct obligations/full faith and credit exempt list:

Fidelity Institutional Cash Treasury  
Merrill Lynch Government Fund

Class 1 list:

BlackRock Provident Temporary Investment Fund  
Dreyfus Cash Management Institutional Shares Government Portfolio  
Dreyfus Cash Management Class A Government Portfolio  
Merrill Lynch Premier Institutional  
Merrill Lynch Institutional Fund  
Provident Institutional Fund  
Dreyfus Money Market

It is recommended that the Company comply with SSAP 2 and the SVO Purposes and Procedures Manual when reporting short-term investments in the annual statement.

#### Receivable From Parent, Subsidiaries and Affiliates

The Company reported an asset for a net receivable from its parent company, OneBeacon Insurance Company (“OneBeacon”) amounting to \$1,205,596 for intercompany balances due to and from OneBeacon pursuant to the pooling agreement. Examination review indicated that balances owing under the pooling agreement were not being settled according to the provisions of the approved agreement.

The pooling agreement provides that the net amounts of all payments due shall be settled among the companies no later than the last day of the month following the close of each calendar quarter. Any amount not paid when due shall bear interest from the due date until the date of payment at an annual rate equal to the prime rate as published in the Wall Street Journal on the due date plus one percent (1%). The Company and OneBeacon did not settle the amount receivable for the period ending December 31, 2001 until April 2, 2002. Such amount was due on January 31, 2002. Furthermore, OneBeacon did not pay any interest as required pursuant to the pooling agreement. It is recommended that the Company comply with its pooling agreement and settle no later than the last day of the month following the close of each calendar quarter all intercompany receivables/payables. For any amount of receivables not paid when due shall bear interest from the due date until the date of payment at an annual rate as described in the pooling agreement.

#### Ceded Reinsurance Premiums Payable

Examination review of the Company's reported liability for "Ceded reinsurance premiums payable" revealed several differences between the supporting documentation and the 2001 annual statement, Schedule F – Part 3 amounts indicated by the Company as being due and payable. These were due, per the Company, to the booking of estimates as opposed to actual payments. Several of these sampled balances could not be supported by actual subsequent settlements. The total amounts actually determined for this liability was \$3,271,302 less than that stated by the OneBeacon Insurance Group pool. The Company's portion of this understatement was \$49,070. No change has been made to this estimated liability for purposes of this examination due to immateriality. However, it is recommended that the Company review its ceded reinsurance premium balances to identify and either adjust or write-off any balances determined to be inaccurate or invalid. It is also recommended that the Company implement the proper internal controls to ensure the accurate financial reporting of all balances relating to ceded

reinsurance business in accordance with the NAIC Annual Statement Instructions and the NAIC Accounting Practices and Procedures Manual.

#### Department Regulation 118 Compliance

Department Regulation 118 sets forth the contractual requirements between an insurer and its certified public accountants (“CPA”). Both the Company and the CPA were unable to provide a copy of a written contract. The Company advised that such document may not exist. It is the responsibility of the Company to obtain such written contract with the CPA to be in compliance with Department Regulation 118. It is recommended that the Company comply with Department Regulation 118.

#### Inability to Provide Examination Requested Information

The Company was unable to provide several requested trade tickets for investments acquired or disposed of during the period covered by this examination. In accordance with Department Regulation 152, Part 243.2(b)(7):

“an insurer shall maintain a financial record necessary to verify the financial condition of an insurer...for six calendar years from its creation or until after the filing of the report on examination in which the record is subject to review, whichever is longer.”

It is recommended that the Company comply with Department Regulation 152, Part 243.2(b)(7) and retain all original documentation for investments until the report on examination has been issued by the Department for the period covering the time that the Company either made an acquisition of an investment and/or disposed of an investment.

#### Errors and Omissions Noted in Annual Statement for 2001

The Company improperly indicated its percentage share of the pooled business in the Notes to Financial Statements, Note 25, of the 2001 annual statement. The correct amount should have been stated as being 1.5%, not 6.5%. The Company additionally improperly indicated an affiliates’ percentage of

participation in the same pool. The correct percentage should have been stated as being 6.5%, not 1.5% for affiliate Homeland Insurance Company of New York. It is recommended that the Company file the correct pool members' participation of the pooled business.

H. Compliance with Section 310 of the New York Insurance Law

During the course of this examination, the examiners encountered significant delays in obtaining from Company management the documentation necessary for the efficient completion of the examination. For a significant period of time during the early stages of the examination, management was extremely slow to respond to examination requests for documentation.

Section 310 (a)(2) of the New York Insurance Law states, in part:

“Any examiner authorized by the superintendent shall be given convenient access at all reasonable hours to the books, records, files, securities and other documents of such insurer or other person, including those of any affiliated or subsidiary companies thereof, which are relevant to the examination...”

Section 310 (a) (3) of the New York Insurance Law states:

“The officers and agents of such insurer or other person shall facilitate such examination and aid such examiners in conducting the same so far as it is in their power to do so”.

During the conduct of the examination, the officers of the Company did not comply with the above referenced sections of Section 310 of the New York Insurance Law, as demonstrated by the following:

- Requests for information were not responded to in a timely manner;
- Documentation or information requested was never provided in some instances.

Numerous memoranda were sent to Company representatives, inquiring as to the status of the examination requests for information. Additionally, several meetings were held between the Company representatives and the examiners to review the outstanding examination requests. All of the above significantly increased the length of the examination, increased the cost of the examination to the Company, and put a strain on the Department's resources. Therefore, it is recommended that the Company comply with Section 310 of the New York Insurance Law.

It should be noted, however, that toward the end of this examination, the Company, under new management roles, took a more active role in the examination process and implemented the necessary changes to facilitate the examination process.

### **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>	
	<u>Assets</u>	<u>Non-admitted Assets</u>	<u>Net Admitted Assets</u>	<u>Assets</u>	<u>Surplus Increase (Decrease)</u>
Bonds	\$69,986,341	\$	\$69,986,341	\$69,986,341	\$
Cash and short term investments	47,745,598		47,745,598	47,745,598	
Receivable for securities	4,927		4,927	4,927	
Premiums, agents' balances in course of collection	743,300		743,300	743,300	
Premiums, agents' balances and installments booked but deferred and not yet due	14,047,496	180,000	13,867,496	14,029,496	(162,000)
Accrued retrosepective premiums	235,583	23,558	212,025	212,025	
Funds held by or deposited with reinsured companies	59,012	12,539	46,473	59,012	(12,539)
Amounts billed and receivable under deductible and service only plans	202,617	2,250	200,367	200,367	
Reinsurance recoverables on loss and loss adjustment expense payments	1,110,034	121,717	988,317	1,110,034	(121,717)
Federal income tax recoverable	3,012,950		3,419,419	3,012,950	406,469
EDP equipment	227,279	101,248	126,031	126,031	
Interest, dividends and real estate income due and accrued	1,238,653		1,238,653	1,238,653	
Receivable from parent, subsidiaries and affiliates	1,205,596		1,205,596	1,205,596	
Equities and deposits in pools and associations	39,764		39,764	39,764	
Other assets non-admitted	97,899	97,899			
Sundry balances	3,148,022	906,850	2,241,172	2,241,172	
Loss suspense	191,394		191,394	191,394	
Funds held by Company or agents under reinsurance treaties	1,027	70	957	957	
<b>Total assets</b>	<b>\$143,297,492</b>	<b>\$1,446,131</b>	<b>\$142,257,830</b>	<b>\$142,147,617</b>	<b>\$ 110,213</b>

<u>Liabilities, Surplus and Other Funds</u>	<u>Examination</u>	<u>Company</u>	<u>Surplus Increase (Decrease)</u>
<u>Liabilities</u>			
Losses & loss adjustment expenses	\$76,619,408	\$70,494,383	\$ (6,125,025)
Reinsurance payable on paid losses and loss adjustment expenses	833,750	810,263	(23,487)
Commissions payable, contingent commissions and other similar charges	972,429	972,429	
Other expenses	2,139,226	2,139,226	
Taxes, licenses and fees	1,014,581	1,014,581	
Federal and foreign income taxes			
Unearned premiums	21,187,409	21,187,409	
Dividends declared and unpaid:			
Policyholders	57,042	57,042	
Ceded reinsurance premiums payable	1,283,059	1,283,059	
Funds held by Company under reinsurance treaties	679,683	679,683	
Amounts withheld or retained by Company for account of others	4,168	4,168	
Drafts outstanding	2,844,611	2,844,611	
Payable for securities	361,170	361,170	
New York Automobile Plan Liability	1,477,275		(1,477,275)
Accounts payable	1,524,707	1,363,560	(161,147)
Pension liabilities	1,026,403	1,026,403	
Reserve for uninsured losses	115,807	115,807	
<b>Total liabilities</b>	<b>\$ 112,140,728</b>	<b>\$ 104,353,794</b>	<b>\$ (7,786,934)</b>
<u>Surplus and Other Funds</u>			
Common capital stock	\$ 1,000,000	\$ 1,000,000	\$
Gross paid in and contributed surplus	33,419,873	33,419,873	
Unassigned funds	(4,302,771)	3,373,949	(7,676,720)
<b>Surplus as regards policyholders</b>	<b>\$ 30,117,102</b>	<b>\$ 37,793,822</b>	<b>\$ (7,676,720)</b>
<b>Total liabilities, surplus and other funds</b>	<b>\$ 142,257,830</b>	<b>\$ 142,147,616</b>	

- NOTES:
- (1) The Internal Revenue Service has indicated that it will initiate an audit for the tax years 2000 – 2002 in 2004. This audit will include CGU Corporation Tax Year ending December 31, 2001 and June 1, 2001. An additional audit will include Fund American Enterprises Holding, Inc. for tax years December 31, 2001 and 2002. The Examiner is unaware of any potential exposure of the Company to any tax assessment.
  - (2) Based upon the results of this examination, the Company's surplus as regards policyholders was found to be impaired in the amount of \$4,882,898. 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 \$35,000,000.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$729,823 during the five-year examination period January 1, 1997, through December 31, 2001, detailed as follows:

Statement of Income

Underwriting Income

Premiums earned		\$ 250,063,438
Deductions:		
Losses and loss adjustment expenses incurred	\$ 217,735,629	
Other underwriting expenses incurred	81,619,504	
Total underwriting deductions		<u>299,355,133</u>
Net underwriting loss		\$ (49,291,695)

Investment Income

Net investment income earned	\$ 24,198,257	
Net realized capital gains	33,006,471	
Net investment gain		<u>57,204,728</u>

Other Income

Net gain (loss) in agents' balances	\$ (1,520,719)	
Finance and service charges not included in premiums	3,146,459	
Miscellaneous income and expenses	(7,647,402)	
Total other income (loss)		<u>(6,021,662)</u>
Net income (loss) before dividends to policyholders and federal and foreign income taxes		\$1,891,371
Dividends to policyholders		<u>1,575,912</u>
Net income (loss), after dividends to policyholders but before federal and foreign income taxes		\$315,459
Federal and foreign income taxes incurred		<u>(1,773,460)</u>
Net income (loss)		<u><u>\$2,088,919</u></u>

### Capital and Surplus Account

Surplus as regards policyholders, per report on examination, as of December 31, 1996		\$29,387,279		
	<table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 50%; text-align: center;"><u>Gains in Surplus</u></th> <th style="width: 50%; text-align: center;"><u>Losses in Surplus</u></th> </tr> </thead> </table>	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
<u>Gains in Surplus</u>	<u>Losses in Surplus</u>			
Net income (loss)	\$ 2,088,919	\$		
Net unrealized capital gains/losses		10,974,981		
Change in nonadmitted assets	164,224			
Change in excess of statutory reserves over statement reserves	82,000			
Cumulative effect of changes in accounting principles		486,760		
Surplus contribution	20,825,000			
Dividends to stockholders		7,000,000		
Merger/reorganization costs		1,978,214		
Sale of EDP equipment	627			
Pension costs		133,590		
Prior period adjustments	<u>          </u>	<u>1,857,402</u>		
Total gains and losses	<u>\$23,160,770</u>	<u>\$22,430,947</u>		
Net increase in surplus as regards policyholders		<u>729,823</u>		
Surplus as regards policyholders, per report on examination, as of December 31, 2001		<u><u>\$30,117,102</u></u>		

**4. PREMIUMS, AGENTS' BALANCES AND INSTALLMENTS BOOKED  
BUT DEFERRED AND NOT YET DUE**

The examination admitted asset of \$13,867,496 is \$162,000 less than the \$14,029,496 reported by the Company as of December 31, 2001. The Company's reported balance included \$180,000 of earned but unbilled premiums as of December 31, 2001. The Company was unable to provide any supporting documentation related to the earned but unbilled portion of the asset other than the \$18,000 asset it non-admitted as uncollectible. The examination non-admitted the entire earned but unbilled balance due to the lack of supporting documentation. It is recommended that the Company non-admit the entire earned but unbilled balance due to lack of supporting documentation.

**5. FUNDS HELD BY OR DEPOSITED WITH REINSURED COMPANIES**

The examination admitted asset of \$46,473 is \$12,539 less than the \$59,012 reported by the Company as of December 31, 2001. The OneBeacon Pool was unable to substantiate some of its funds held by or deposited with reinsurance companies as reported in Schedule F- Part 1 of the 2001 annual statement. The Company shares 1.5% of this asset through its participation in the OneBeacon Pool. The Company's portion of this unsubstantiated asset balance amounts to \$12,539. It is recommended that the Company research its funds held balances and write-off against surplus, any balances that can not be substantiated.

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

The examination admitted asset of \$988,317 is \$121,717 less than the \$1,110,034 reported by the Company as of December 31, 2001. The Company, as a member of the OneBeacon Pool, participates in the placement and operation of reinsurance on risks assumed and ceded. The OneBeacon Pool was unable to provide supporting documentation for several of its reinsurance recoverable balances of which the Company shares 1.5%. The Company's portion of the unsupported asset balance amounts to

\$121,717. This amount has been non-admitted for purposes of this report on examination. It is recommended that the Company review its internal controls surrounding the reporting of this asset account, and implement the necessary procedures to ensure the accurate reporting of reinsurance recoverable balances. It is further recommended that the Company research all of its reinsurance balances and write-off against surplus, any balances that are determined to be unsubstantiated.

#### **7. FEDERAL INCOME TAX RECOVERABLE**

The examination admitted asset of \$3,419,419 is \$406,469 more than the \$3,012,950 as reported by the Company as of December 31, 2001. Subsequent to filing the 2001 annual statement, the Company filed its 2001 Federal Income Tax Return Form 1120-PC on a consolidated basis with the other insurance companies of the Fund American Enterprises Holdings, Inc. group wherein it was determined that the actual recoverable amount was \$3,419,419.

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

The examination liability of \$76,619,408 is \$6,125,025 more than the \$70,494,383 liability reported by the Company as of December 31, 2001. The Company reported \$59,261,467 in its December 31, 2001 annual statement for losses and \$11,232,916 for loss adjustment expenses for a total of \$70,494,383.

The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based upon statistical information contained in the Company's internal records and filed annual statements.

As part of the December 31, 2001 examination of OneBeacon Insurance Company, the Pennsylvania Insurance Department retained the consulting actuarial firm of KPMG LLP ("KPMG") to

perform a reserve analysis of the 2001 losses and loss adjustment expenses of the OneBeacon Pool, of which the Company has a 1.5% portion. The results of KPMG's analysis indicated that the December 31, 2001 reserves for losses and loss adjustment expenses, as reported by the OneBeacon Pool, were deficient by \$408,335,000, net of reinsurance. The OneBeacon Pool was not able to provide KPMG with detailed historical information with respect to the OneBeacon Pool's losses and loss adjustment expenses on a gross of external reinsurance basis. The OneBeacon Pool attributes this situation to lack of gross data compiled by the OneBeacon Pool before a merger of the lead company in the OneBeacon Pool, OneBeacon Insurance Company, a Pennsylvania domiciled insurer. Consequently, the data provided by the OneBeacon Pool was not sufficient in KPMG's opinion to render an opinion with respect to the OneBeacon Pool's reserves gross of external reinsurance. It is recommended that the Company begin to have the OneBeacon Pool compile losses and loss adjustment expense data on a gross of external reinsurance basis.

In addition to the reserve deficiency noted above, the examiners encountered difficulty in verifying some of the loss data. Statistical samples were selected from the One Beacon Company's database for data validation. Of the 834 claim files selected, only 738 claim files were received by the examination team and reviewed. The remaining 96 claims were not provided to the examination team as requested. The Company's failure to locate 96 claim files, or 11.5% of the sample is a significant internal weakness. It is recommended that the Company improve its procedures relative to the storage and maintenance of its claim files.

Further, Department Regulation 152 provides minimum time for record retention of customer records by insurers. The retention requirements for claim files being (1) six calendar years after all elements of the claim are resolved and the file is closed, or (2) until after the filing of the report on

examination in which the claim file was subject for review. It is recommended that the Company comply with the record retention requirements per Department Regulation 152.

**9. REINSURANCE PAYABLE ON PAID LOSSES AND LOSS ADJUSTMENT EXPENSES**

The examination liability of \$833,750 is \$23,487 more than the \$810,263 reported by the Company as of December 31, 2001. At December 31, 2001, the OneBeacon Pool reported a reinsurance payable liability of \$54,017,525 (gross of intercompany pooling). The Company's share of this liability amounted to \$833,750. A review of underlying documentation supporting these reinsurance payables revealed inconsistencies between the 2001 annual statement, Schedule F-Part 1 amounts payable and the supporting documentation. This liability was understated at year-end 2001 based upon a review of subsequent disbursements relating to these payables. The understatement amounted to \$1,565,799 for the OneBeacon Pool and \$23,487 for the Company. This additional liability amount has been established for purposes of this report on examination. It is recommended that: 1) the Company (the OneBeacon Pool) review its reinsurance payables to identify and either adjust or write-off any balances determined to be inaccurate or invalid; 2) the Company implement the proper internal controls to ensure the accurate financial reporting of all balances relating to reinsurance assumed business; and, 3) the Company settle all outstanding reinsurance balances with ceding companies on a timely basis and in accordance with the terms and conditions of the underlying contracts.

**10. NEW YORK AUTOMOBILE INSURANCE PLAN LIABILITY**

The Company reported no liability under this caption as of the examination date. This examination has established the captioned liability in the amount of \$1,477,275. During 2003, the Company amended its 2002 annual statement to reflect an unrecorded liability. The lead insurance company in the reinsurance Pool, OneBeacon Insurance Company had determined that a liability existed at December 31, 2001, for the Company's share of the liabilities under the New York Automobile

Insurance Plan (“NYAIP”). This liability amounted to \$1,477,275 and was properly recorded in the amended annual statement for 2002 as amended on July 10, 2003.

It is noted that in accordance with SSAP No. 3, “Accounting Changes and Corrections of Errors”, that an adjustment was recorded to opening surplus as of January 1, 2002. The effect of recording the proportionate share of the Pool’s losses associated with future market assignments on the January 1, 2002 surplus amounted to \$1,477,275. Accordingly, it appears that as of the examination date, December 31, 2001, the surplus for the Company should be reduced by this amount through the establishment of a liability account “NYAIP Liability”. It is recommended that the Company establish a liability for the NYAIP and annually record the changes to the liability account as a result of the Company’s participation in the NYAIP.

#### **11. ACCOUNTS PAYABLE**

The examination liability of \$1,524,707 is \$161,147 more than the \$1,363,560 reported by the Company as of December 31, 2001. The Company’s admitted portion of this pooled liability, \$1,363,560, consists of accounts payable by the Company through its 1.5% participation in the OneBeacon Pool allocation of \$90,903,991. A review was conducted of the two largest sub-accounts for this liability. This review determined that these two accounts were understated by a total of \$10,743,140 on a pooled basis from documentation received indicating the actual amounts paid to settle these accounts payable. The Company’s portion of the increase in these liabilities amounts to \$161,147.

#### **12. MARKET CONDUCT ACTIVITIES**

In the course of this examination, a review was made of the manner in which the Company conducts its business practices 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 the New York Department of Insurance.

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

Claims and Complaint Handling

Except as noted relative to the lack of record retention, no problem areas were encountered.

**13. CONCLUSION**

This examination has determined that the Company's surplus as regards policyholders is impaired in the amount of \$4,882,898.

It is noted that the surplus as regards policyholders as of December 31, 2002, December 31, 2003 and March 31, 2004, as reported to this Department in the filed statements, is in excess of the required \$35,000,000. The Company's subsequent reported surplus as regards policyholders reflects increases to the losses and loss adjustment expense reserves for accident years 2001 and prior, as well as the establishment of the New York Automobile Insurance Plan liability.

**14. 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 properly age premiums and agents' balances and report as non-admitted assets those balances over 90 days past due in accordance with Section 1301(a)(11) of the New York Insurance Law.</p> <p>The Company has complied with this recommendation.</p>	<p>21</p>

ITEMPAGE NO.B. Federal Income Taxes

It was recommended that the Company adjust its records to reflect the correct federal income tax liability. 22-23

The Company has complied with this recommendation. It is noted however that a financial change to Federal income taxes recoverable is made in this report on examination.

**15. SUMMARY OF COMMENTS AND RECOMMENDATIONS**ITEMPAGE NO.A. Impairment

As a result of this examination, the Company's surplus as regards policyholders has been decreased by \$7,676,720, with surplus as regards policyholders as being determined to be \$30,117, 102 as of December 31, 2001. Since the Company is licensed to write multiple reinsurance pursuant to Section 4102(c) of the New York Insurance Law, the Company is required to maintain a minimum surplus of \$35,000,000. Thus, the Company's surplus as regards policyholders as determined by this examination is impaired in the amount of \$4,882,898. 1

It is noted that the surplus as regards policyholders as of December 31, 2002, December 31, 2003 and March 31 2004, as reported to this Department in the filed statements, is in excess of the required \$35,000,000. The Company's subsequent reported surplus as regards policyholders reflects increases to the losses and loss adjustment expense reserves for accident years 2001 and prior, as well as the establishment of the New York Automobile Insurance Plan liability.

i. Management

It is recommended that the Company adhere to the provisions of its charter and by-laws and maintain the minimum number of directors on its board of directors at all times. 6

<u>ITEM</u>	<u>PAGE NO.</u>
B. <u>Reinsurance</u>	
It is recommended that the Company ensure that the lead company execute formal written authorizations with its reinsurance intermediaries in order to comply with New York Insurance Regulation 98.	16
It is also recommended that the Company and/ or the OneBeacon Pool implement the necessary internal controls to ensure that the written authorizations entered into between the Company and its reinsurance intermediaries are available for review upon request.	16
C. <u>Accounts and Records</u>	
i. <u>Custody Agreement</u>	
It is recommended that the custodial agreement between Mellon Trust of New York and the Company be amended to contain all of the proper controls and safeguards as mandated by the NAIC Financial Condition Examiners Handbook.	21
Subsequent to the examination date, effective April 27, 2004, the Company entered into an amended and restated custody agreement with Mellon Trust of New York, LLC. This agreement contains the proper controls and safeguards.	
ii. <u>Securities Lending Authorization Agreement</u>	
(a) It is recommended that the Company amend its securities lending authorization agreement to have the agreement construed in accordance with the laws of the State of New York.	22
Subsequent to the examination date, effective May 13, 2004, the Company and Mellon Bank, N.A. executed an amendment to the securities lending authorization changing the governing law to the laws of the State of New York.	
(b) It is recommended that the Company comply with the instructions to the annual statement by identifying in its Schedule D of the annual statement those assets that were not under the exclusive control of the Company.	22
It is noted that the Company properly identified those assets that were not under the exclusive control of the Company in its 2003 annual statement.	

<u>ITEM</u>	<u>PAGE NO.</u>
iii. <u>Proper Classification of Short-term Investments</u>	
It is recommended that the Company comply with SSAP 2 and the SVO Purposes and Procedures Manual when reporting short-term investments in the annual statement.	23
iv. <u>Receivable From Parent, Subsidiaries and Affiliates</u>	
It is recommended that the Company comply with its pooling agreement and settle no later than the last day of the month following the close of each calendar quarter all intercompany receivables/payables. For any amount of receivables not paid when due shall bear interest from the due date until the date of payment at an annual rate as described in the pooling agreement.	24
v. <u>Ceded Reinsurance Premiums Payable</u>	
It is recommended that the Company review its ceded reinsurance premiums balances to identify and either adjust or write-off any balances determined to be inaccurate or invalid.	24
It is also recommended that the Company implement the proper internal controls to ensure the accurate financial reporting of all balances relating to ceded reinsurance business in accordance with the NAIC Annual Statement Instructions and the NAIC Accounting Practices and Procedures Manual.	24
vi. <u>Department Regulation 118 Compliance</u>	
It is recommended that the Company comply with Department Regulation 118.	25
vii. <u>Inability to Provide Examination Requested Information</u>	
It is recommended that the Company comply with Department Regulation 152, Part 243.2(b)(7) and retain all original documentation for investments until the report on examination has been issued by the Department for the period covering the time that the Company either made an acquisition of an investment and/or disposed of an investment.	25
viii. <u>Errors and Omissions Noted in Annual Statement 2001</u>	
It is recommended that the Company file the correct pool members' participation percentages of the pooled business.	26

<u>ITEM</u>	<u>PAGE NO.</u>
<u>Compliance with Section 310 of the New York Insurance Law</u>	
D. It is recommended that the Company comply with Section 310 of the New York Insurance Law.	27
It is noted that toward the end of this examination, the Company, under new management roles, took a more active role in the examination process and implemented the necessary changes to facilitate the examination process.	
E. <u>Premiums, Agents' Balances and Installments Booked But Deferred and Not Yet Due</u>	
It is recommended that the Company non-admit the entire earned but unbilled balance due to the lack of supporting documentation.	32
F. <u>Funds Held By or Deposited With Reinsured Companies</u>	
It is recommended that the Company research its funds held balances and write-off against surplus, any balances that can not be substantiated.	32
G. <u>Reinsurance Recoverables on Loss and Loss Adjustment Expense Payments</u>	
It is recommended that the Company review its internal controls surrounding the reporting of this asset account, and implement the necessary procedures to ensure the accurate reporting of reinsurance recoverable balances. It is further recommended that the Company research all of its reinsurance balances and write-off against surplus, any balances that are determined to be unsubstantiated.	33
H. <u>Losses and Loss Adjustment Expenses</u>	
It is recommended that the Company begin to have the OneBeacon Pool to compile losses and loss adjustment expense data on a gross of external reinsurance basis.	34
It is recommended that the Company improve its procedures relative to the storage and maintenance of its claim files.	34
It is recommended that the Company be mindful of the record retention requirements per Department Regulation 152.	35

ITEMPAGE NO.I. Reinsurance Payable on Paid Losses and Loss Adjustment Expenses

It is recommended that: 1) the Company (the OneBeacon Pool) review its reinsurance payables to identify and either adjust or write-off any balances determined to be inaccurate or invalid; 2) the Company implement the proper internal controls to ensure the accurate financial reporting of all balances relating to reinsurance assumed business; and, 3) the Company settle all outstanding reinsurance balances with ceding companies on a timely basis and in accordance with the terms and conditions of the underlying contracts.

35

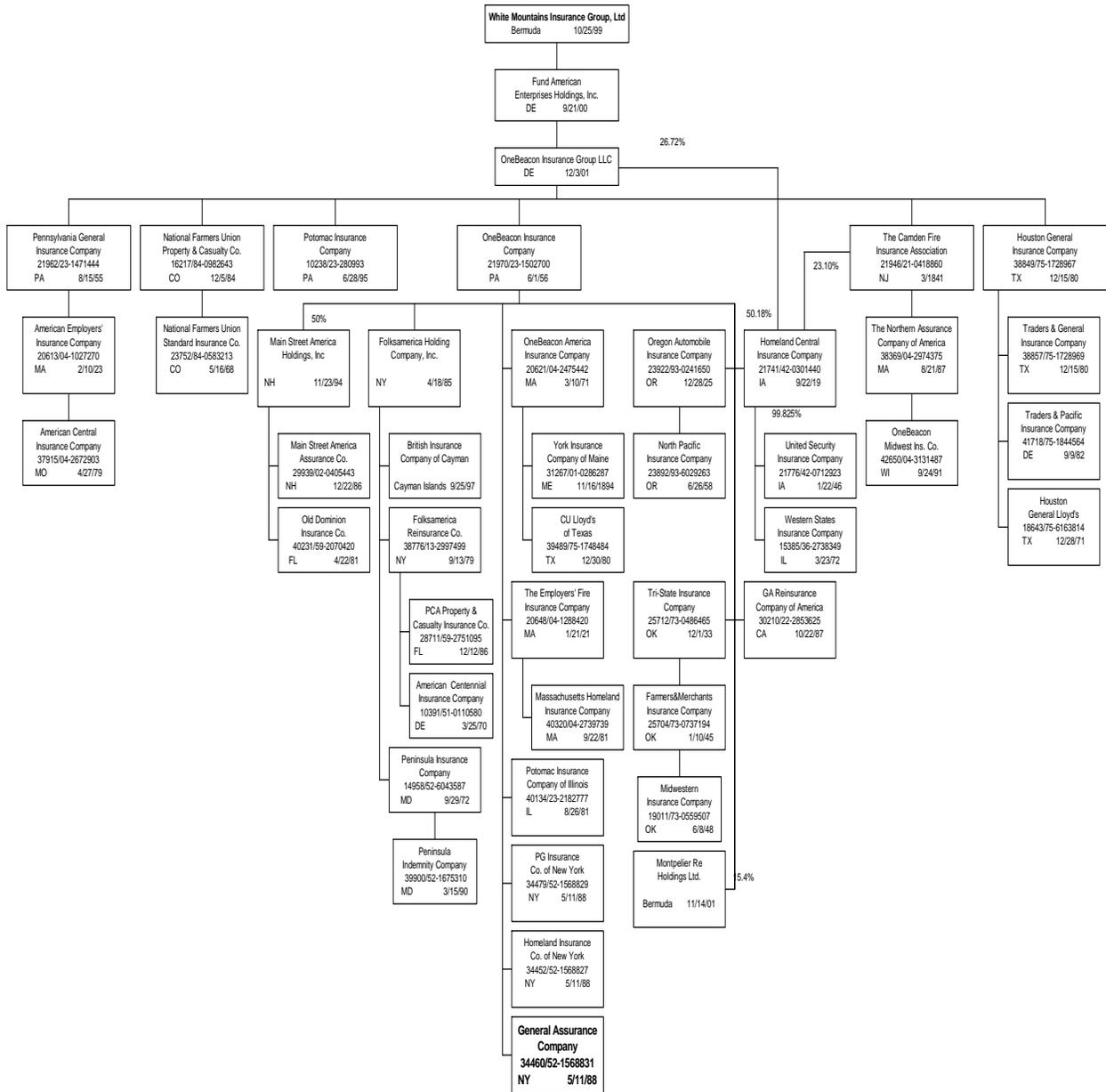
J. New York Automobile Insurance Plan Liability

It is recommended that the Company establish a liability for the New York Automobile Plan Liability and annually record the changes to the liability account as a result of the Company's participation in the NYAIP.

36

It is noted that in accordance with SSAP No. 3, "Changes and Corrections of Errors", that an adjustment was recorded to opening surplus as of January 1, 2002 per the Company's filed amended annual statement for 2002.

# ORGANIZATION CHART



Note: National Grange Mutual Insurance Company owns the remaining 50% of Main Street Holdings, Inc.

Respectfully submitted,

\_\_\_\_\_/s/\_\_\_\_\_  
Larry E. Cross, CFE, CIE  
Examiner-In-Charge

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

LARRY E. CROSS, being duly sworn, deposes and says that the foregoing report, subscribed to him, is true to the best of his knowledge and belief.

\_\_\_\_\_/s/\_\_\_\_\_  
Larry E. Cross

Subscribed and sworn to before me  
this \_\_\_\_\_ day of \_\_\_\_\_, 2005.

Appointment No. 21974

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:

**Larry Cross**

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

**PG INSURANCE COMPANY OF NEW YORK**

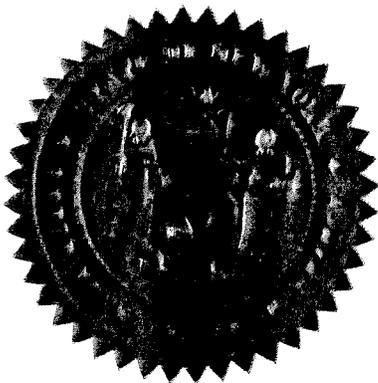
*and to make a report to me in writing of the condition of the said*

**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 9th day of December, 2002*



  
\_\_\_\_\_  
GREGORY V. SERIO  
Superintendent of Insurance