REPORT ON EXAMINATION

OF THE

STATE INSURANCE FUND DISABILITY BENEFITS FUND

AS OF

DECEMBER 31, 2009

DATE OF REPORT	DECEMBER 15, 2010
EXAMINER	MOSES EGBON

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

December 15, 2010

Honorable James J. Wrynn
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 30398 dated November 15, 2009 attached hereto, I have made an examination into the condition and affairs of the State Insurance Fund Disability Benefits Fund as of December 31, 2009, and submit the following report thereon.

Wherever the designation “DB Fund” appears herein without qualification, it should be understood to indicate the State Insurance Fund Disability Benefits Fund. The State Insurance Fund, for purposes of this report, refers to the New York State agency, which administers the operations of the Disability Benefit Fund, which is the subject of this examination report, and the Workers Compensation Fund.

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

The examination was conducted at the New York City office of the State Insurance Fund located at 199 Church Street, New York, New York, 10007.

1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 2003. This examination covered the six-year period from January 1, 2004 through December 31, 2009. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

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

All financially significant accounts and activities of the DB Fund were considered in accordance with the risk-focused examination process. This examination also included a review and evaluation of the DB Fund's own control environment assessment. The examiners also relied upon audit work performed by the DB Fund's independent public accountants when appropriate.

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

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

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

The examination of the DB Fund was performed concurrently with the examinations of the State Insurance Fund Workers' Compensation Fund and the Aggregate Trust Fund. The Aggregate Trust Fund is another fund administered by the State Insurance Fund. The purpose of the Aggregate Trust Fund is to assure and oversee the regular payment of benefits on adjudicated death cases and certain permanent disability cases.

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 DB FUND

The State Insurance Fund ("the Fund") was created in 1914, pursuant to the provisions of Article 6, Section 76 of the New York Workers' Compensation Law ("NYWCL"). Its primary purpose was to provide workers' compensation insurance for employers in the State of New York. The Fund is comprised of two separate funds; the Workers' Compensation Fund ("WC Fund") and the Disability Benefits Fund ("DB Fund"). The WC Fund insures employers against occupational injury and disease suffered by their employees; the DB Fund insures against disabling off-the-job sickness or injury sustained by employees. The DB Fund was created in 1950 by amendment to Section 76 of the NYWCL.

The Fund is required to maintain separate records and file separate financial statements for the WC Fund and the DB Fund. This report is confined to the operations of the DB Fund. A separate report on examination was prepared for the WC Fund.

A. Management

Pursuant to Article 6, Section 77 of the NYWCL, the Fund shall be administered by a Board of Commissioners consisting of ten members. The New York State Labor Commissioner is a member by virtue of the office, with the other members being appointed by the Governor with the consent of the State Senate. The commissioners are appointed for terms of three years each and they must be policyholders insured by the State Insurance Fund. It is noted that as of the examination date, the Board of Commissioners had only eight members; therefore, there were two vacancies.

In 2007, Section 77 of the NYWCL was amended to increase the number of members from eight to ten, with one of the new commissioners to be appointed by the Governor upon the recommendation of the New York State AFL-CIO, and the other new commissioner to be appointed upon the recommendation of the Business Council of the State of New York.

The board meets every month, with the exception of August, during each calendar year. At December 31, 2009, the board of directors consisted of the following eight members:

Name and Residence	Principal Business Affiliation
Robert H. Hurlbut (Chairman) Honeoye Falls, NY	President, Hurlbut Trust
Denis M. Hughes New York, NY	President, New York AFL-CIO
H. Sidney Holmes III Springfield Garden, NY	Corporate Partner, Winston & Strawn LLP
Raymond Wayne LeChase Rochester, NY	Chairman and Managing Partner, LeChase Construction,
Charles L. Loiodice Woodbury, NY	President and Chief Executive Officer, Paris Maintenance, Inc.
David E. Ourlicht Rye, NY	Senior Vice President of Marketing & Sales, Amalgamated Bank
Colleen Gardner (ex-officio) Albany, NY	Commissioner, State Department of Labor
Kenneth R. Theobalds New Rochelle, NY	Vice President of Government Affairs, Entergy Nuclear Northeast

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended

Section 82 of Article 6 of the NYWCL prescribes that the commissioners shall appoint an executive director, a general attorney and a secretary for terms of nine years each. The executive director shall, subject to the direction of the commissioners, be responsible for the direction and operation of the Fund. As of December 31, 2009, the principal officers of the DB Fund were as follows:

Name	Title
Francine James	Chief Deputy Executive Director
Thomas William Gleason	Deputy Executive Director
Shirley Stark	Deputy Executive Director
Jean Marie Woodard	Deputy Executive Director
Gregory John Allen	General Attorney
Michael James Milano	Assistant Secretary to the Board

In addition, the DB Fund has established an audit committee, which reports to the board of directors and helps the board fulfill its oversight responsibilities with respect to its financial reporting process and system of internal controls.

B. Territory and Plan of Operation

The DB Fund operates only in the State of New York. It is authorized to transact disability benefits insurance, which it writes on a direct basis according to Article 9 of the New York Workers Compensation Law ("WCL"). The Disability Benefits Law (Article 9 of the WCL) provides for weekly cash benefits to replace, in part, wages lost due to injuries or illnesses that do not arise out of or in the course of employment.

The following schedule shows the direct premiums written by the DB Fund during the examination period:

Calendar Year	Direct Premiums Written
2004	$16,632,083
2005	$16,784,128
2006	$19,102,444
2007	$14,311,484
2008	$16,983,672
2009	$16,593,975

C. Reinsurance

Assumed and Ceded

The DB Fund is strictly a direct writer and did not assume or cede any reinsurance during the examination period.

D. Significant Operating Ratios

The following ratios have been computed as of December 31, 2009, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	17%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	27%
Premiums in course of collection to surplus as regards policyholders	-9%

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 DB Fund reported a negative balance for premiums in course of collection, which created a negative ratio as indicated above. The reason for the negative balance is discussed in Item 2E (Accounts and Records) of this report.

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

	Amounts	Ratios
Losses and loss adjustment expenses incurred	$75,236,804	76.20%
Other underwriting expenses incurred	20,012,964	20.27
Net underwriting gain	3,489,968	3.53
Premiums earned	$98,739,736	100.00%

E. Accounts and Records

i) Custodial Agreement

The examiner noted that the custodian agreement between the DB Fund and JP Morgan Chase lacked the following protective covenant set forth in Section 3-56 of the 2009 NAIC Financial Condition Examiners Handbook ("Handbook"), which states as follows:

> "If the custodial agreement has been terminated or if 100% of the account assets in any one custody account have been withdrawn, the custodian shall provide written notification, within three business days of termination or withdrawal, to the insurer's domiciliary commissioner."

It is recommended that the DB Fund amend its custodian agreement with JP Morgan Chase to include the above protective covenant set forth in Section 3-56 of the 2009 Handbook.

ii) Contract with Certified Public Accountants

The engagement letter between the DB Fund and its Certified Public Accountant is missing the following provisions required by Department Regulation 118, which states in part:

> "Every insurer subject to this Part shall retain an independent Certified Public Accountant (CPA) who agrees by written contract with such insurer to comply with the provisions of section 307(b) of the Insurance Law, this Part and the Code of Professional Conduct adopted by the American Institute of Certified Public Accountants (AICPA). Such contract must specify that:
>
> (a) on or before May 31st, the CPA shall provide an audited financial statement of such insurer and of any subsidiary required by section 307(b)(1) of the Insurance Law together with an opinion on the financial statements of such insurer and any such subsidiary for the prior calendar year and an evaluation of the insurer's and any such subsidiary's accounting procedures and internal control systems as are necessary to the furnishing of the opinion;
>
> (b) any determination by the CPA that the insurer has materially misstated its financial condition as reported to the superintendent or that the insurer does not meet minimum capital or surplus to policyholder requirements set forth in the Insurance Law shall be given by the CPA, in writing, to the superintendent within 15 calendar days following such determination; and
>
> (c) the workpapers and any communications between the CPA and the insurer relating to the audit of the insurer shall be made available for review by the superintendent at the offices of the insurer, at the Insurance Department or at any other reasonable place designated by the superintendent. The CPA must retain for review such workpapers and communications in accordance with the provisions of Part 243 of this Title (Regulation 152). More specifically, such workpapers and communications must be retained by the CPA for the period specified in sections 243.2(b)(7) and (c) of this

> Title. For the purposes of this subdivision, the workpapers and communications shall be deemed to have been created on the date the filing required by section 89.2(a) of this Part was submitted to the superintendent."

It is recommended that the DB Fund include the provisions required by Department Regulation 118 in all future contracts with its CPA firm. It is noted that Department Regulation 118 was revised effective January 1, 2010, and therefore, the DB Fund should comply with the revised Regulation.

iii) Uncollected Premiums and Agents' Balances in Course of Collection

The DB Fund's uncollected premiums totals include a significant number of credit balances that have been netted against positive receivables. A cursory review indicated that some of these credit balances appear to be dated. Offsetting and netting of assets and liabilities are only permitted in accordance with the provisions of Paragraph 2 of NAIC Accounting Practices and Procedures Statement of Statutory Accounting Principles ("SSAP") No. 64, which states:

> "Assets and liabilities shall be offset and reported net only when a valid right of setoff exists except as provided for in paragraphs 3 and 4. A right of setoff is a reporting entity's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying an amount that the other party owes to the reporting entity against the debt. A valid right of setoff exists only when all the following conditions are met:
>
> a. Each of the two parties owes the other determinable amounts. An amount shall be considered determinable for purposes of this provision when it is reliably estimable by both parties to the agreement;
>
> b. The reporting party has the right to setoff the amount owed with the amount owed by the other party;
>
> c. The reporting party intends to setoff; and
>
> d. The right of setoff is enforceable at law."

Further, Paragraph 4 of SSAP 64 states:

> "Netting of assets and liabilities for reporting purposes when no valid right of setoff exists shall be allowed only when provided for by specific statements of statutory accounting principles. An example of such is in the case of real estate investments required to be shown net of encumbrances as provided for in SSAP No. 40—Real Estate Investments."

It is recommended that the DB Fund review the netting of credit balances against its uncollected premiums to determine if the netting is in accordance with SSAP No. 64.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2009 as determined by this examination and as reported by the Company:

Assets	Assets	Assets Not Admitted	Net Admitted Assets
Bonds	$124,608,166	$ 0	$124,608,166
Preferred stocks	4,921,649		4,921,649
Common stocks	279,796		279,796
Cash, cash equivalents and short-term investments	9,607,809		9,607,809
Receivable for securities	4,053,428		4,053,428
Investment income due and accrued	984,920		984,920
Uncollected premiums and agents' balances in the course of collection	(8,502,007)	111,754	(8,613,761)
Deferred premiums, agents' balances and installments booked but deferred and not yet due	3,010,451		3,010,451
Electronic data processing equipment and software	1,808		1,808
Prepaid expenses	29,471	29,471	0
Total assets	$138,995,491	$141,225	$138,854,266

Liabilities, Surplus and Other Funds

Liabilities		
Losses and loss adjustment expenses		$ 5,031,267
Other expenses (excluding taxes, licenses and fees)		346,628
Taxes, licenses and fees		(149,582)
Unearned premiums		32,937,232
Advance premium		510,454
Amounts withheld or retained by company for account of others		(4,373)
Payable to parent, subsidiaries and affiliates		268,406
Payable for securities		3,729,636
Estimated expense of Workers' Compensation Board		(128,681)
Miscellaneous suspense		2,959
Total liabilities		$ 42,543,946
Surplus and Other Funds		
Security Fluctuation Surplus	$ 4,000,000	
Epidemic and Catastrophe Surplus	4,000,000	
Unassigned funds (surplus)	88,310,320	
Surplus as regards policyholders		96,310,320
Total liabilities and surplus and other funds		$138,854,266

NOTE: The Fund is exempt from federal income tax.

B. Statement of Income

Underwriting Income		
Premiums earned		$98,739,736
Deductions:		
Losses incurred	$66,246,750	
Loss adjustment expenses incurred	8,990,054	
Other underwriting expenses incurred	20,012,964	
Total underwriting deductions		95,249,768
Net underwriting gain or (loss)		$3,489,968
Investment Income		
Net investment income earned	$28,028,854	
Net realized capital gain	12,576,833	
Net investment gain or (loss)		40,605,687
Other Income		
Net gain or (loss) from agents' or premium balances charged off	$(5,955,862)	
Finance and service charges not included in premiums	1,162,670	
Credit balance charged off	1,249,546	
Miscellaneous income	59,494	
Cost and interest receivable adjustment	9,416	
Total other income		$(3,474,736)
Net income		$40,620,919

C. Capital and Surplus Account

Surplus as regards policyholders increased $43,083,517 during the six-year examination period January 1, 2004 through December 31, 2009, detailed as follows:

Surplus as regards policyholders per report on examination as of December 31, 2003			$53,226,803
	Gains in Surplus	Losses in Surplus	
Net income	$40,620,919		
Change in net unrealized capital losses		$1,519,100	
Change in non-admitted assets	4,131,230		
Net effect on surplus from conversion	0	149,532	
Total gains and losses	$44,752,149	$1,668,632	
Net increase (decrease) in surplus			43,083,517
Surplus as regards policyholders per report on examination as of December 31, 2009			$96,310,320

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of $5,031,267 is the same as reported by the DB Fund as of December 31, 2009. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the DB Fund's internal records and in its filed annual statements.

5. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the DB Fund 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 DB Fund in the following areas:

A. Underwriting
B. Claims and complaint handling

No problem areas were encountered.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

ITEM		PAGE NO.
A.	Abandoned Property Law	
	It was recommended that the Fund comply with the provisions of Section 1316 of the New York Abandoned Property Law and file the abandoned property reports on a timely basis.	6
	The Fund has complied with this recommendation.	
B.	Custodial Agreement	
	It was recommended that the Fund update its custodial agreement to reflect the name of the current custodian.	6
	The Fund has complied with this recommendation.	

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM		PAGE NO.
A.	Accounts and Records	
i.	Custodial Agreement	
	It is recommended that the DB Fund amend its custodial agreement with JP Morgan Chase to include the protective covenant suggested by Section 3-56 of the 2009 Handbook.	7
ii.	Fund's Contract with Certified Public Accountants	
	It is recommended that the DB Fund include the provisions required by Department Regulation 118 in all future contracts with its CPA firm. It is noted that Department Regulation 118 was revised effective January 1, 2010, and therefore, the DB Fund should comply with the revised Regulation.	8
iii.	Uncollected Premiums and Agents' Balances in Course of Collection	
	It is recommended that the DB Fund review the netting of credit balances against its uncollected premiums to determine if the netting is in accordance with SSAP No. 64.	8

Respectfully submitted,

/s/

Moses Egbon, CFE
Senior Insurance Examiner

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

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

/s/

Moses Egbon

Subscribed and sworn to before me

this__________ day of ___________________, 2011.

Appointment No. 30398

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, James J. Wrynn *Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:*

Moses Egbon

as proper person to examine into the affairs of the

STATE INSURANCE FUND DISABILITY BENEFITS FUND

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

Fund

with such other information as he shall deem requisite.

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

this 15th *day of* November, *2009*

JAMES J. WRYNN
Superintendent of Insurance