

REPORT ON EXAMINATION

OF THE

PARAMOUNT INSURANCE COMPANY

AS OF

DECEMBER 31, 2003

DATE OF REPORT

MAY 23, 2005

EXAMINER

FE ROSALES, CFE

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

May 23, 2005

Honorable Howard Mills
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 22264 dated October 28, 2004 attached hereto, I have made an examination into the condition and affairs of Paramount Insurance Company as of December 31, 2003, and submit the following report thereon.

Wherever the designations “the Company” or “Paramount” appear herein without qualification, they should be understood to indicate Paramount Insurance Company.

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 Company’s administrative offices located at One Park Avenue, New York, New York 10016.

1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1999. This examination covered the four-year period from January 1, 2000 through December 31, 2003. 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, 2003. The examination included a review of income, disbursements and company records deemed necessary to accomplish such analysis or verification and utilized, to the extent considered appropriate, work performed by the Company's independent public accountants. A review or audit was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners ("NAIC"):

- History of Company
- Management and control
- Corporate records
- Fidelity bond and other insurance
- Territory and plan of operation
- Growth of Company
- Business in force by states
- Loss experience
- Reinsurance
- Accounts and records
- Financial statements

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 COMPANY

Paramount Insurance Company was incorporated under the laws of the State of New York on June 4, 1980 and licensed on July 13, 1981.

Direct control of the Company is held by PSM Holding Corporation (“PSM Holding”), which in turn, is controlled directly by Public Service Mutual Insurance Company (“PSM”), the parent company of the Magna Carta Companies Inc.

Since January 1992, Paramount and PSM have pooled premiums, losses and expenses under a reinsurance pooling agreement.

The Company’s capital paid in is \$4,200,000 consisting of 4.2 million shares of common stock at \$1 par value per share of common stock. Gross paid in and contributed surplus is \$13,300,000. These amounts have not changed since the prior examination.

A. Management

Pursuant to the Company’s charter and by-laws, management of the Company shall be vested in a board of directors consisting of minimum of fifteen members up to a maximum of twenty-four at any time. Each director shall serve on the board for a term of three years following his or her election by a majority vote of the Company’s policyholders during their annual meeting.

As of December 31, 2003, there were fifteen directors as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Charles Lanham Crouch, III La Canada, CA	Attorney, Perkins Coie LLP
Andrew Lawrence Furgatch Los Angeles, CA	Chairman of the Board, Paramount Insurance Company

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Julius Gantman White Plains, NY	Attorney, Tellerman, Taticoff & Greenberg
Anita Davis Goodman Hartsdale, NY	Real Estate Broker
John David Hatch Ocala, FL	Attorney, Insurance Horizons, Inc.
Donald Henderson Aromas, CA	Insurance Consultant
John Thomas Hill, II Pennington, NJ	President, Paramount Insurance Company
David Anthony Lawless Mamaroneck, NY	Senior Vice President, Paramount Insurance Company
Harold Norman London Malverne, NY	Certified Public Accountant, Freeman & Davis, LLP
Stanley Joseph Mastrogiacomo Warwick, NY	Insurance Consultant
Milton Peckman Coconut Creek, FL	Attorney and Secretary, Paramount Insurance Company
Paul Steven Schweitzer Potomac, MD	Business Executive, Julien J. Studley, Inc.
Leslie Wilfred Seldin, D.D.S. New York, NY	Dentist
Lewis James Spellman, Ph. D. Austin, TX	Professor, University of Texas
Irwin Wallace Young Manhasset, NY	Business Executive, DuArt Film Labs, Inc.

The board met four times each year during the examination period as stipulated in the Company's by-laws. The minutes of all meetings of the board of directors held during the examination period were reviewed. All meetings were generally well attended by the board members.

The Company also has executive, investment and compensation committees comprised of three board members per committee. Designated board members serve on their respective committees for one year at a time and are elected annually by majority votes of the board.

It is noted that the Company has no established procedure for disclosure to its board of directors of any material interest or affiliation on the part of any of its officers or responsible employees which is in or likely to conflict with the official duties of such person.

It is also noted that the Company did not respond accurately to Question #14 of the General Interrogatory which asks:

"Has the reporting entity an established procedure for disclosure to its board of directors of any material interest or affiliation on the part of any of its officers, directors, trustees or responsible employees which is in or likely to conflict with the official duties of such person?"

It is recommended that all officers and responsible employees complete conflict of interest questionnaires annually to disclose all possible conflicts to the board of directors.

It is also recommended that the Company respond accurately to all General Interrogatory questions of the annual statement.

As of December 31, 2003, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Andrew Furgatch	Chairman and Chief Executive Officer
John Thomas Hill II	President
Milton Peckman	Secretary
Daniel Tagliaferro	Vice President and Treasurer
David Lawless	Senior Vice President

<u>Name</u>	<u>Title</u>
Lonnie Cagley	Vice President, Underwriting
John Lawrence Gaddy	Vice President, Claims
Louis Masucci	Vice President, Underwriting
Theodore Smyk	Vice President, Claims

It is noted that Daniel Tagliaferro resigned from the Company effective November 2004.

B. Territory and Plan of Operation

As of December 31, 2003, the Company was licensed to write business in the States of New York, Massachusetts, New Jersey and Pennsylvania.

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

<u>Paragraph</u>	<u>Line of Business</u>
3	Accident & health
4	Fire
5	Miscellaneous property damage
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
10	Elevator
11	Animal
12	Collision
13	Personal injury liability
14	Property damage liability
15	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

In addition, the Company is licensed to transact such workers' compensation insurance as may be incident to coverages contemplated under paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law, including coverage described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69th Congress as amended; 33 USC Section 901 et seq. as amended).

Based upon the lines of business for which the Company is licensed, and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, Paramount is required to maintain a minimum surplus to policyholders in the amount of \$2,150,000.

The Company's principal lines of business are commercial multiple peril and workers compensation, which account for approximately 90% of the Company's 2003 net written premiums. The Company specializes in commercial package policies and workers' compensation for restaurants, mercantile establishments, habitational risks, and light manufacturing risks. Business is produced through independent agents and brokers.

The following schedule shows the direct premiums written by the Company both in total and in New York for the period under examination:

DIRECT PREMIUMS WRITTEN

<u>Calendar Year</u>	<u>New York State</u>	<u>Total United States</u>	Premiums Written in New York State as a percentage of United States <u>Premiums Written</u>
2000	\$16,843,890	\$23,356,619	72.12%
2001	\$19,177,476	\$27,116,950	70.72%
2002	\$19,701,829	\$26,672,797	73.86%
2003	\$22,541,868	\$28,682,788	78.59%

C. ReinsuranceAssumed

The Company's reinsurance assumed business stems from the Company's participation in an inter-company pooling arrangement with its ultimate parent company, Public Service Mutual Insurance Company ("PSM"), a New York domiciled property and casualty company. Under the agreement, the Company cedes 100% of its net direct business to PSM and assumes 10% of the combined net business from PSM, excluding voluntary assumed reinsurance.

Ceded

The Schedule F data as contained in the Company's filed annual statements accurately reflect its reinsurance transactions.

The examiner reviewed all ceded reinsurance contracts in effect at December 31, 2003. The contracts all contained the required standard clauses including the insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law.

The Company has the following reinsurance program as of December 31, 2003:

TreatyCessionProperty

First Surplus
90% Authorized

Up to five times the minimum net retention of \$250,000 per risk subject to a maximum cession of \$10,000,000 per risk. Maximum occurrence limit of \$24,000,000.

Per Risk Excess of Loss
(2 layers)
68.5% Authorized

\$9,700,000 excess of \$300,000 each and every risk. Maximum any one occurrence limit of \$19,400,000.

Catastrophe Excess of Loss
(6 layers)
67% Authorized

95% of \$97,000,000 excess of \$3,000,000 ultimate net loss each and every loss occurrence.

Casualty

Excess of Loss
(2 layers)
100% Authorized

75% of \$10,350,000 ultimate net loss excess of \$650,000 ultimate net loss each loss occurrence.

Clash
90% Authorized

\$14,000,000 excess of \$11,000,000 ultimate net loss each loss occurrence.

Workers' Compensation
Catastrophe Excess of Loss
100% Authorized

\$10,000,000 excess of \$25,000,000 each loss occurrence.

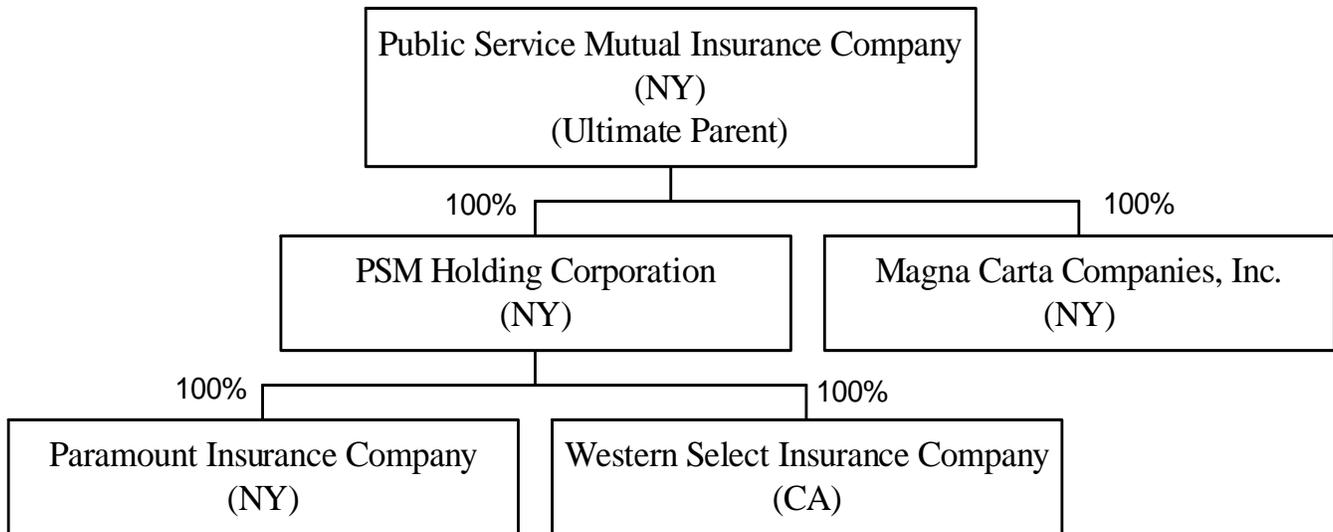
Except for the workers' compensation catastrophe excess contract whose retention amount increased from \$5,000,000 at December 31, 1999 to \$25,000,000 at December 31, 2003, the Company's ceded reinsurance program remains basically unchanged since the prior examination.

D. Affiliated Companies

The Company is a member of the Magna Carta Companies ("MCC"). Public Service Mutual Insurance Company ("PSM") is the sole stockholder of PSM Holding Corporation, which in turn owns 100% of Paramount.

A review of the Regulation 53 filings (subsidiaries' reports) filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 16 of the New York Insurance Law and Department Regulation 53.

The following is a chart of the affiliated group at December 31, 2003:



PSM is the ultimate parent company and is a domestic mutual insurance company. Therefore, it is not subject to Article 15 of the New York Insurance Law.

On January 1, 2000, PSM and its subsidiaries ceased using the trade name PSM Insurance Companies and commenced marketing under the name, Magna Carta Companies (“MCC”).

In addition to the existing inter-company pooling and reinsurance agreement between PSM and Paramount, the following agreements in effect at December 31, 2003 with other members of its affiliated group, were filed with, and approved by the Department:

1. Service Agreement with PSM

Under this agreement, PSM makes available the services of its personnel, office space, equipment, and other services. The Company's cost of such services is shared consistent with the same rate of the pooling agreement. The review of the allocation of expenses between the parties revealed that the charges are reasonable and in accordance with the requirements of Department Regulation No. 30.

2. Tax Allocation Agreement

Under this agreement, PSM, Paramount, Western Select, PSM Holding Corporation and Magna Carta Companies, Inc. file a consolidated income tax return with the Internal Revenue Service. The review of this agreement revealed that it is in compliance with Department Circular Letter No. 33 (1979).

E. Abandoned Property Law

Section 1316 of the New York Abandoned Property Law provides that amounts payable to a resident of this state from a policy of insurance, if unclaimed for three years, shall be deemed to be abandoned property. Such abandoned property shall be reported to the comptroller on or before the first day of April of each year. Such filing is required of all insurers regardless of whether or not they have any abandoned property to report.

The Company's abandoned property reports for the period of this examination were all filed on a timely basis pursuant to the provisions of Section 1316 of the New York Abandoned Property Law.

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 2003, based upon the results of this examination:

Net premiums written in 2003 to surplus as regards policyholders	60%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	63%
Premiums in course of collection to surplus as regards policyholders	8%

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 four-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$41,930,136	81.53%
Other underwriting expenses incurred	18,885,101	36.72
Net underwriting loss	<u>(9,403,492)</u>	<u>(18.28)</u>
Premiums earned	<u>\$51,411,745</u>	<u>100.00%</u>

G. Accounts and Records

i. Custodian Agreement with Bank of New York

The review of the Company's custodian agreement with Bank of New York revealed that the agreement lacks four of the twelve NAIC custodian agreement provisions. The provisions missing are as follows:

- a) That in the event that the custodian gains entry in a clearing corporation through an agent, there should be a written agreement between the custodian and the agent that the agent shall be subjected to the same liability for loss of securities as the custodian. If the agent is governed by laws that differ from the regulation of the custodian, the Commissioner of Insurance of the state of domicile may accept a standard of liability applicable to the agent that is different from the standard liability;
- b) The custodian and its agents, upon reasonable request, shall be required to send all reports which they receive from a clearing corporation or the Federal Reserve book-entry system which the clearing corporation or the Federal Reserve permits to be redistributed and reports prepared by the custodian's outside auditors, to the insurance company on their respective systems of internal control;
- c) That the custodian shall provide, upon written request from a regulator or an authorized officer of the insurance company, the appropriate affidavits, with respect to the insurance company's securities held by the custodian;
- d) That the custodian shall secure and maintain insurance protection in an adequate amount.

It was also noted that the Company's response to General Interrogatory #23 regarding custodian agreements was not accurately filled out.

It is recommended that the Company amend its custodian agreement to include all the protective covenants and provisions in order to comply with the requirements set forth in the NAIC Financial Condition Examiners Handbook and Department guidelines.

Subsequent to the examination date, the Company amended its custodian agreement with the Bank of New York to include the missing provisions.

It is also recommended that the Company respond accurately to General Interrogatory questions of the annual statement.

ii. Certified Public Accountant Contract with KPMG LLP

The Company retained KPMG LLP as its independent certified public accountant (“CPA”) during the period under examination. The review of the Company’s contract with its CPA firm for the 2003 audit revealed that the contract does not fully comply with the requirements specified in Section 89.2 of Department Regulation 118, which states that:

“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”.

The review revealed that the contract does not contain the underlined matters in the above regulation.

It is therefore recommended that the Company ensure that the contract with its CPA comply with the requirements of Department Regulation 118.

iii. Investment Reconciliation

During the review of the Company's investment reconciliation, it was noted that there are several securities on special deposit at other banks. Many of these special deposits are listed in the Bank of New York (“BONY”) statement as R/B/R (Registered by Receipt). These securities are designated as R/B/R since they are on deposit with another state and are not held by BONY. However, in some cases the state holding these special deposits was not noted in the reconciliation which look as if BONY holds the securities.

It is recommended that the Company, when performing an investment reconciliation, list on a separate column all of its special deposits with other states in order to facilitate the review of its investments.

iv. Remittances and Items Not Allocated

The Company reported two suspense accounts as an offset against Uncollected premiums and not as the liability account - Remittances and items not allocated.

The NAIC Annual Statement Instructions for 2003 indicate the following:

“Report a liability for cash receipts that cannot be identified for a specific purpose or, for other reasons, cannot be applied to a specific account when received which include items in suspense”.

In addition, Paragraph No. 9 of the NAIC Accounting Practices and Procedures Manual, Statements of Statutory Accounting Principles (“SSAP”) No. 67 (Other liabilities), states:

“Cash receipts cannot always be identified for a specific purpose or, for other reasons, applied to a specific account when received. The reporting entity shall record a liability for these cash receipts when the funds are received. These liability accounts are generally referred to as suspense accounts”.

Based on the Annual Statement Instructions and SSAP No. 67 indicated above, the two suspense accounts should have been classified as Remittances and items not allocated of the 2003 annual statement and not as an offset against Premiums in course of collection.

It is therefore recommended that in future annual statements filed with this Department, the Company correctly classify annual statement accounts in accordance with the NAIC Annual Statement Instructions.

It is further recommended that the Company comply with SSAP No. 67 and record suspense accounts as Remittances and items not allocated.

v. Earned but Unbilled Premiums

The Company did not report earned but unbilled (“EBUB”) premiums as part of the “Deferred premiums, agents' balances and installments booked but deferred and not yet due” line of the 2003 annual statement asset page. However, the examiner’s verification revealed that audit premiums for workers' compensation policies should have been reported as EBUB premiums.

It is recommended that the Company properly classify audit premiums as earned but unbilled premiums and disclose it in parenthesis in the “Deferred premiums, agents' balances and installments booked but deferred and not yet due” line in the asset page of the annual statement.

vi. Electronic Data Processing Equipment (“EDP”) Depreciation

The Company used 7-year straight line depreciation method for computer hardware.

In accordance with SSAP No. 79, EDP equipment and operating system software should be depreciated over the lesser of its useful life or three years.

It is recommended that the Company adhere to the provisions of SSAP No. 79 when recording the depreciation for its EDP equipment.

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders this examination as of December 31, 2003:

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$52,682,674	\$0	\$52,682,674
Cash, cash equivalents and short-term investments	774,394	0	774,394
Investment income due and accrued	717,009	0	717,009
Uncollected premiums and agents' balances in the course of collection	2,330,434	279,329	2,051,105
Deferred premiums, agents' balances and installments booked but deferred and not yet due	1,620,934	0	1,620,934
Amounts recoverable from reinsurers	42,429		42,429
Net deferred tax asset	1,049,791	0	1,049,791
Receivables from parent, subsidiaries and affiliates	975,213	0	975,213
Aggregate write-ins for other than invested assets	<u>633,457</u>	<u>53,240</u>	<u>580,217</u>
Total assets	<u>\$60,826,335</u>	<u>\$332,569</u>	<u>\$60,493,766</u>

Liabilities, Surplus and Other FundsLiabilities

Losses	\$21,824,735
Loss adjustment expenses	4,823,776
Commissions payable, contingent commissions and other similar Charges	172,872
Other expenses (excluding taxes, licenses and fees)	184,352
Taxes, licenses and fees (excluding federal and foreign income taxes)	675,781
Unearned premiums	7,797,180
Policyholders (dividends declared and unpaid)	13,621
Ceded reinsurance premiums payable (net of ceding commissions)	7,346
Amounts withheld or retained by company for account of others	(4,018)
Provision for reinsurance	31,091
Aggregate write-ins for liabilities	<u>155,138</u>
Total liabilities	\$35,681,874

Surplus and Other Funds

Common capital stock	\$4,200,000
Gross paid in and contributed surplus	13,300,000
Unassigned funds (surplus)	<u>7,311,892</u>
Surplus as regards policyholders	<u>24,811,892</u>
Total liabilities, surplus and other funds	<u>\$60,493,766</u>

NOTE: The Internal Revenue Service has never audited the Company's consolidated Federal Income Tax Returns. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders decreased by \$3,172,354 during the four-year examination period January 1, 2000 through December 31, 2003, detailed as follows:

Underwriting Income

Premiums earned		\$51,430,536
Deductions:		
Losses incurred	\$30,441,818	
Loss adjustment expenses incurred	11,488,318	
Other underwriting expenses incurred	18,885,101	
Aggregate write-ins for underwriting deductions	<u>18,791</u>	
Total underwriting deductions		<u>60,834,028</u>
Net underwriting gain or (loss)		\$ (9,403,492)

Investment Income

Net investment income earned	\$13,837,160	
Net realized capital gains	<u>1,534,371</u>	
Net investment gain or (loss)		15,371,531

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$(283,411)	
Finance and service charges not included in premiums	34,390	
Aggregate write-ins for miscellaneous income	<u>254,339</u>	
Total other income		<u>5,318</u>
Net income before dividends to policyholders and before federal and foreign income taxes		\$5,973,357
Dividends to policyholders		<u>718,524</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$5,254,833
Federal and foreign income taxes incurred		<u>0</u>
Net income		<u>\$5,254,833</u>

Capital and Surplus Account

Surplus as regards policyholders per report on examination as of December 31, 1999			\$27,984,246
	<u>Gains in</u>	<u>Losses in</u>	
	<u>Surplus</u>	<u>Surplus</u>	
Net income	\$5,254,833		
Change in net deferred income tax	818,390		
Change in nonadmitted assets	122,149		
Change in provision for reinsurance	5,073		
Surplus (contributed to) withdrawn from protected cells	13,556		
Cumulative effect of changes in accounting principles	663,645		
Dividends to stockholders	<u>0</u>	<u>\$10,050,000</u>	
Total gains and losses	<u>\$6,877,646</u>	<u>\$10,050,000</u>	
Net increase (decrease) in surplus			<u>(3,172,354)</u>
Surplus as regards policyholders per report on examination as of December 31, 2003			<u>\$24,811,892</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$26,648,511 is the same as reported by the Company as of December 31, 2003. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Company's internal records and in its filed annual statements.

In accordance with annual statement instructions, the Company is required to provide claims count data for claims reported, claims outstanding, and claims closed with payment in Schedule P of its filed annual statement. During the review of losses, data anomalies were noted in the claims count data reported in Schedule P - Part 5 of the Company's filed 2003 annual statement.

The data irregularities for the number of claims reported - direct & assumed noted in the Company's Schedule P for the year ended December 31, 2003 are as follows:

- Workers' Compensation business -For certain years (1996 through 1999) the cumulative number of claims reported decreased from year-end 2001 to year-end 2002.

It is recommended that the Company provide accurate claims count data and that the Schedule P be accurately completed in all future statements filed with the Department.

It is noted that the Company, after being notified of the data irregularities, corrected Schedule P in its 2004 filed annual statement.

5. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the more precise scope of a market conduct investigation, which is the responsibility of the Market Conduct Unit of the Property Bureau of this Department.

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

- A. Sales and advertising
- B. Underwriting
- C. Rating
- D. Claims and complaint handling

The following was noted upon review of the claims and complaint handling practices:

i. Regulation 64 Compliance

The review of a sample of ten complaints revealed that the Company did not respond to the Department within ten business days for two complaint cases as required by Section 216.4(d) of Department Regulation 64 which states in part:

“Every insurer, upon receipt of any inquiry from the Insurance Department respecting a claim, shall, within 10 business days, furnish the department with the available information requested respecting the claim”.

It is noted that the Company acknowledged this exception.

In addition, a sample of the Company's claim files was reviewed for compliance with the provisions of Department Regulation 64 Part 216. The review revealed the following:

(1) It was noted that the Company did not comply with Section 216.6(c) of Department Regulation 64 which states in part that:

“Within 15 business days after receipt by the insurer of a properly executed proof of loss and/or receipt of all items, statements and forms which the insurer requires from the claimant, the claimant, or the claimant's authorized representative, shall be advised in writing of the acceptance or rejection of the claim by the insurer”.

There were two exceptions found for this specific section. The Company acknowledged these exceptions.

Furthermore, Section 216.6(f) of Department Regulation 60 states in part:

“Not later than 5 business days from the receipt of an agreement by the insurer or from the date of the performance by the claimant of any condition set by such agreement, insurer shall pay any amount finally agreed upon in settlement of all or part of any claim”.

There was one exception noted for this specific section which the Company acknowledged.

(2) Section 216.11 of Department Regulation 64 states in part:

“To enable department personnel to reconstruct an insurer's activities, all insurers subject to the provisions of this Part must maintain within each claim file all communications, transactions, notes and work papers relating to the claim. All communications and transactions, whether written or oral, emanating from or received by the insurer shall be dated by the insurer. Claim files must be so maintained that all events relating to a claim can be reconstructed by the Insurance Department examiners. Insurers shall either make a notation in the file or retain a copy of all forms mailed to claimants”. (Emphasis added.)

It is noted that one claim file did not comply with this specific section of Department Regulation 64 as the settlement release is not found in the file. In addition, as of the examination date, the Company

did not retain copy of the acknowledgment letter sent to agents / claimants. Thus, the Company did not comply with this section for all claim files sampled.

It is recommended that the Company fully and strictly comply with the time requirement provisions of Sections 216.4 and 216.6 of Department Regulation 64. In addition, it is recommended that the Company fully comply with Section 216.11 of Department Regulation 64 and maintain within each claim file all communications, transactions, notes and workpapers relating to the claim as required by this specific section of Department Regulation 64.

The Company acknowledged that it did not routinely retain copy of the acknowledgment card sent to agents notifying them that the claim has been received. Moreover, as of September 1, 2004, when the Company reverted from legal to letter size claim folders, all copies of the claims acknowledgment card became permanent part of the claim folders.

3. Complaints

The review of the Company's 2000 through 2003 complaint logs for compliance with the requirements of Circular Letter No. 11 (1978) revealed that four of the eleven columns/items were not included, as follows:

1. The person within the company to whom the matter has been referred for review.
2. The date of such referral.
3. The chronology of further contacts with this Department.
4. Remarks about internal remedial action taken as a result of the investigation.

It is therefore recommended that the Company comply with the requirements of Circular Letter No. 11 (1978) and going forward maintain a complaint log that encompasses the eleven topics required in this circular letter.

The Company acknowledged that four of the eleven items mentioned in the Circular letter are not evident in their log. As such, the Company indicated that, on a going forward basis, the complaint log will be redesigned to include the above-indicated four missing items to ensure compliance with the circular letter.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
It was recommended that the Company maintain for each director rendering outside consulting services to Company, individual formal written agreements approved by the board of directors.	5
The Company has complied with this recommendation.	
B. <u>Affiliated Companies</u>	
i. It was recommended that the parent company file with the Insurance Department the formation of the subsidiary, Magna Carta Companies Inc., pursuant to Section 1603 of the New York Insurance Law. In addition, it is recommended that the Company comply with the said statute in the future by notifying the Department prior to the formation of a subsidiary.	10
The Company has complied with this recommendation.	
ii. It was recommended that the parent company comply with the Circular Letter No. 33(1979) by filing with the Insurance Department an amended tax allocation agreement reflecting Magna Carta Companies, Inc. and Western Select Insurance Company as parties therein. In addition, it is recommended that those entities no longer affiliated with the Group be removed.	11
The Company has complied with this recommendation.	

<u>ITEM</u>	<u>PAGE NO.</u>
iii. It was recommended that the Company revise its inter-company service agreement to refer to the State of New York instead of the State of California. The Company has complied with this recommendation.	11
C. <u>Abandoned Property Law</u>	
It was recommended that the Company maintain its records adequately to ensure that all claimants' names will be on record during each year in which unclaimed funds are escheated to the State, in accordance with Section 1316 of the New York State Abandoned Property Law. The Company has complied with this recommendation.	13
D. <u>Accounts and Records</u>	
i. It was recommended that all Company records be available upon request in a timely manner in order to facilitate future examinations. The Company has complied with this recommendation.	13
ii. It was recommended that the Company prepare routine reconciliations of its invested asset accounts between the Company and custodial bank records. The Company has complied with this recommendation; however, in some cases the state holding the special deposits was not noted in the reconciliation. A recommendation relative to investment reconciliation is included in this current report on examination. (Refer to Item 7.B.iii.)	13
E. It was recommended that the Company report accurate claim counts data in Schedule P of the filed annual statement. The Company has not complied with this recommendation during the examination period as anomalies in the claim counts data were also found. Therefore, this is being repeated in this current report.	18

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
i. It is recommended that all officers and responsible employees complete conflict of interest questionnaires annually to disclose all possible conflicts to the board of directors.	5
ii. It is also recommended that the Company respond accurately to all General Interrogatory questions of the annual statement.	5, 14
B. <u>Accounts and Records</u>	
i. <u>Custodian Agreement</u>	
It is recommended that the Company amend its custodian agreement to include all the protective covenants and provisions in order to comply with the requirements set forth in the NAIC Financial Condition Examiners Handbook and Department guidelines.	13
ii. <u>Certified Public Accountant Contract</u>	
It is recommended that the Company ensure that the contract with its CPA comply with the requirements of Department Regulation 118.	15
Subsequently, prior to the report on examination, the Company amended its custodian agreement with Bank of New York to include the missing provisions.	
iii. <u>Investment Reconciliation</u>	
It is recommended that the Company, when performing an investment reconciliation, list on a separate column all of its special deposits with other states in order to facilitate the review of its investments.	15
iv. <u>Remittances and Items Not Allocated</u>	
It is recommended that in future annual statement filed with this Department, the Company correctly classify annual statement accounts in accordance with the NAIC Annual Statement Instructions.	16
It is further recommended that the Company comply with SSAP No. 67 of the NAIC Accounting Practices and Procedures Manual and to record suspense accounts as Remittances and items not allocated.	16

<u>ITEM</u>	<u>PAGE NO.</u>
v. <u>Earned but Unbilled Premiums</u>	
<p>It is recommended that the Company properly classify audit premiums as earned but unbilled premiums (“EBUB”) and disclose in parenthesis on the “Deferred premiums, agents' balances and installments booked but deferred and not yet due” line in the asset page of the annual statement.</p>	17
vi. <u>Electron Data Processing Equipment</u>	
<p>It is recommended that the Company adhere to the provisions of SSAP No. 79 when recording the depreciation of its EDP equipment.</p>	17
C. <u>Loss and Loss Adjustment Expenses</u>	
<p>It is recommended that the Company provide accurate claims count data and that the Schedule P be accurately completed in all future statements filed with the Department.</p> <p>It is noted that the Company, after being notified of the data irregularities, corrected Schedule P in its recently 2004 filed annual statement.</p>	22
D. <u>Market Conduct Activities</u>	
i. <u>Regulation 64 Compliance</u>	
<p>It is recommended that the Company fully and strictly comply with the time requirement provisions of Sections 216.4 and 216.6 of Regulation 64. In addition, it is recommended that the Company fully comply with Section 216.11 of Department Regulation 64 and maintain within each claim file all communications, transactions, notes and workpapers relating to the claim as required by this specific section of Regulation 64.</p>	25
ii. <u>Complaints</u>	
<p>It is recommended that the Company comply with the requirements of Circular Letter No. 11 (1978) and going forward maintain a complaint log that encompasses the eleven topics required in this circular letter.</p>	26

Appointment No 22264

*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:*

Fe Rosales

as proper person to examine into the affairs of the

PARAMOUNT INSURANCE COMPANY

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

Company

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 28th day of October, 2004



GREGORY V. SERIO
Superintendent of Insurance