REPORT ON EXAMINATION

OF THE

EASTERN MUTUAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2004

| | |
|---|---|
| DATE OF REPORT | APRIL 3, 2006 |
| EXAMINER | NYANTAKYI AKUOKO |

STATE OF NEW YORK
INSURANCE DEPARTMENT
ONE COMMERCE PLAZA
ALBANY, NEW YORK 12257

George E. Pataki
Governor

Howard Mills
Superintendent

April 3, 2006

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 instructions contained in Appointment Number 22432 dated November 3, 2005 hereto, I have made an examination into the condition and affairs of Eastern Mutual Insurance Company as of December 31, 2004, and submit the following report thereon.

Wherever the designations "the Company" or "EMIC" appear herein without qualification, they should be understood to indicate Eastern Mutual 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 home offices located at 6404 State Route 32, Greenville, New York 12083.

TABLE OF CONTENTS


| ITEM NO. | | | PAGE NO. |
|---|---|---|---|
| 1. | Scope of examination | | 2 |
| 2. | Description of company | | 2 |
| | A. | Management | 3 |
| | B. | Territory and plan of operation | 4 |
| | C. | Reinsurance | 6 |
| | D. | Holding company system | 7 |
| | E. | Abandoned Property Law | 9 |
| | F. | Significant operating ratios | 9 |
| | G. | Accounts and records | 10 |
| 3. | Financial statements | | 11 |
| | A. | Balance sheet | 11 |
| | B. | Underwriting and investment exhibit | 13 |
| 4. | Losses and loss adjustment expenses | | 14 |
| 5. | Market conduct activities | | 14 |
| 6. | Compliance with prior report on examination | | 16 |
| 7. | Summary of comments and recommendations | | 17 |

## 1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1999. This examination covered the five-year period from January 1, 2000 through December 31, 2004, and was limited in scope to these balance sheet items considered by this Department to require analysis, verification or description, including: invested assets, inter-company balances, loss and loss adjustment expense reserves and the provision for reinsurance. Transactions occurring subsequent to this period were reviewed, where deemed appropriate by the examiner. 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 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

Eastern Mutual Insurance Company was organized on January 8, 1855 as the Farmers' Fire Insurance Association of the Towns of Greenville, Durham, Westerlo, and Rensselaerville for the purpose of transacting business as an assessment co-operative fire insurance corporation in the counties of Greene and Albany in this State. Subsequently, the Company's territory was extended to include all of the counties of New York State, excluding the counties of New York, Kings, Queens, Bronx and Richmond.

In 1969, this Department approved a change of name of the Company to the Eastern Co-operative Insurance Company. Effective July 1, 1992, this Department approved a merger of Schoharie & Schenectady Mutual Insurance Association into Eastern Co-operative Insurance Company (surviving corporation). Concurrent with the merger, the Company’s license was amended to indicate its new name, Eastern Mutual Insurance Company.

Effective November 21, 2001, this Department approved a change in the Company’s charter to amend its license to include boiler and machinery.

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 nine nor more than fifteen members. At least four board meetings were held each year for the period under examination, thereby complying with Section 6624(b) of the New York Insurance Law (“NYIL”). At December 31, 2004, the board of directors was comprised of the following nine members:

| Name and Residence | Principal Business Affiliation |
|---|---|
| Valerie A. Davis<br>Greenville, NY | Vice President & Secretary, EMIC |
| Robert E. Flagler<br>Berne, NY | Chairman of the Board, EMIC |
| Elizabeth J. Friedland<br>Albany, NY | Retired |
| Scott T. Jeffers<br>Oriskany Falls, NY | President, Sauquoit Valley Insurance Company |
| Kent L. Johnson<br>Rensselaer, NY | System analyst, Rensselaer Polytechnic Institute |

| Name and Residence | Principal Business Affiliation |
|---|---|
| William R. Scrafford<br>Greenville, NY | President & Treasurer, EMIC; President of Chestertown Brokers, Inc |
| Edward R. Waldron<br>Middleburgh, NY | Retired dairy farmer; Director of Chestertown Brokers, Inc |
| Allyn P. Wright<br>Medusa, NY | Self employed forestry consultant; Director, Chestertown Brokers, Inc. |
| Alan P. Zuk<br>Berne, NY | Transport co-coordinator, Berne Know Westerlo Central School |

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

As of December 31, 2004, the principal officers of the Company were as follows:

| Name | Title |
|---|---|
| Douglas J. Wacek | Chief Executive Officer |
| Michael W. Nobles | Chief Financial Officer |
| William R. Scrafford | President & Treasurer |
| Valerie A. Davis | Vice President & Secretary |
| Susan M. Fancher | Vice President-Underwriting |

## B. Territory and Plan of Operation

As of December 31, 2004, the Company was licensed to write business in New York only.

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

| Paragraph | Line of Business |
|---|---|
| 4 | Fire |
| 5 | Miscellaneous property damage |
| 6 | Water damage |
| 7 | Burglary and theft |
| 8 | Glass |
| 9 | Boiler and machinery |
| 12 | Collision |
| 13 | Personal injury liability |
| 14 | Property damage liability |
| 15 | Workers’ compensation and employers’ liability (excluding workers’ compensation) |
| 19 | Motor vehicle and aircraft physical damage |
| 20 | Marine and inland marine (inland marine only) |

The Company is also licensed as of December 31, 2004, to accept and cede reinsurance as provided in Section 6606 of the NYIL

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

| Calendar Year | Direct Premiums Written (000's) |
|---|---|
| 2000 | $4,390 |
| 2001 | 4,799 |
| 2002 | 5,406 |
| 2003 | 6,035 |
| 2004 | 6,584 |

Based on the lines of business for which the Company is licensed and pursuant to the requirements of Articles 13 and 66 of the NYIL, the Company is required to maintain a minimum surplus to policyholders in the amount of $100,000. The company underwrites predominantly commercial multiple peril and homeowners multiple peril lines of business, which accounted for 55% and 27% respectively, of the 2004 direct premium writings. The company writes direct business through independent agents.

C. Reinsurance

The company did not assume reinsurance premiums written as of December 31, 2004.

The company has structured its ceded reinsurance program to limit its maximum exposure to any one risk as follows:

| | |
|---|---|
| Property Excess of Loss (3 layers) | \$430,000 excess of \$70,000 ultimate loss each risk, not exceeding \$60,000, \$300,000 and \$500,000 ultimate net loss any one occurrence for each respective layer. |
| | For business classified as specified catastrophe, \$475,000 excess of \$25,000 subject to a further limit of \$100,000 in any one occurrence. |
| Casualty lines(3 layers) | \$930,000 excess of \$70,000 ultimate net loss occurrence. |
| Casualty Clash | \$2,000,000 excess of \$1,000,000 ultimate net loss per occurrence. |
| Property Catastrophe Excess of Loss (3 layers) | 95% of \$670,000 excess of \$130,000 ultimate net loss, any one loss occurrence, involving three or more risks. |
| | 100% ultimate net loss excess of \$800,000. |
| Aggregate Excess of Loss | 95% of \$650,000 of aggregate net losses, any one contract year in excess of 72.5% of the net premium earned. |
| First Surplus | 3 times the Company’s net retention of \$100,000 with max. cession of \$300,000 any one risks. |
| Boiler and Machinery | 100% cession not exceeding \$25,000,000 any one risk, subject to written agreement. |

In addition to its treaty reinsurance program, the Company also obtained facultative reinsurance coverage. The maximum cession for the program is $1,500,000 liability, after a minimum retention of $300,000 as respects any one risk, covering business classified as fire and allied lines, inland marine and Section 1 only of Homeowners, Farmowners and Commercial Multi-Peril.

Since the previous examination, the Company's retention has increased from $45,000 to $70,000 on property business and $43,000 to $70,000 on casualty business. All of the business written in 2004 was ceded to authorized or accredited companies.

The Schedule F's data as contained in the Company's filed annual statement was found to accurately reflect its reinsurance transactions.

The Company filed all of its reinsurance contracts with the Department during the five years covered by the examination in pursuant to Section 1308(e) of the NYIL.

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

All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in paragraphs 25 and 26 of the NAIC Accounting Practices and Procedures Manual ("SSAP") No. 62.

## D. Holding Company System

### i. Affiliation with Union Mutual Fire Insurance Company

As of December 31, 2004, the Company was affiliated with Union Mutual Fire Insurance Company ("Union Mutual"), a Vermont based insurance company, by virtue of an affiliation agreement, common management, service agreements, and reinsurance agreements.

On May 26, 2000, the Department approved an affiliation agreement between the Company and Union Mutual. The approval paved the way for Union Mutual to provide specified services to the Company. As of December 31, 2004, Union Mutual provided data processing, investment, and accounting management services to the Company under agreements that were filed with the Department.

Also during the examination period, the Company ceded reinsurance to Union Mutual, its affiliate. As of December 31, 2004, the Property and Casualty Combination Excess of Loss contract provided reinsurance coverage for property, casualty, casualty clash, equipment breakdown and aggregate risks.

As of December 31, 2004, the Company had six addenda and two addenda for the Property & Casualty Combination Excess of Loss and the Equipment Breakdown reinsurance agreements, respectively. The Company, in most of the years under examination, did not meet the filing requirements as put forth in the Circular Letter 17 of 2001.

Section 308 of the New York Insurance Law authorizes the Superintendent to require an authorized insurer to submit special reports in relation to its transactions or condition or any matter connected therewith. With such statutory authority, the Superintendent required certain authorized insurers that were heretofore exempt from Article 15 of the NYIL to comply with Article 15 through the issuance of Circular Letter 17 of 2001. Therefore, it is recommended that the Company comply with Section 308 of the NYIL and Circular Letter 17 of 2001 by filing transactions involving the Company and affiliates as prescribed by Article 15 of the NYIL.

ii. Chestertown Brokers, Inc.

In February 1982, this Department approved the organization of a wholly owned subsidiary called Chestertown Brokers, Inc. (“Chestertown”). The purpose of the brokerage subsidiary was to provide additional property and casualty outlets to agents of the EMIC or those lines of business not written by the Company. In 1987, the board of directors of the Company appointed Chestertown as an agent of the Company.

The Company has contributed capital to the subsidiary by purchasing thirty shares of $100 par value common stock at $200 per share for a total investment of $6,000. It is noted that at December 31, 2004, the Company valued its Chestertown investment at $51,317 which represents the entity's audited net worth at such date.

Chestertown is sited at the Company's home office. An agreement was entered into between the Company and the subsidiary whereby the Company provides specified management and operational services to Chestertown. The agreement also provides for operating expenses incurred and paid for by the Company to be allocated between the two companies in a manner consistent with this Department's Regulation 30 (11NYCRR105-109).

## E. Abandoned Property Law

Section 1316 of the New York State 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 abandoned property. Such abandoned property shall be reported to the comptroller on or before the first day of April each year. Such filing is required of all insurers regardless of whether or not they have any abandoned property to report. For the five year examination period, the Company filed abandoned property reports to comply with the law.

## F. Significant Operating Ratios

The following ratios have been computed as of December 31, 2004, based upon the result of this examination:

| | |
|---|---|
| Net premiums written to surplus as regards policyholders | 88% |
| Liabilities to liquid assets (cash and invested assets less investments in affiliates) | 56% |
| Premiums in course of collection to surplus as regards policyholders | 4% |

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 earned/incurred basis and encompass the five-year period covered by this examination:

| | Amounts | Ratios |
|---|---|---|
| Losses and loss adjustment expenses incurred | $ 9,690,569 | 54.52% |
| Other underwriting expenses incurred | 7,280,404 | 40.96% |
| Net underwriting gain | 804,041 | 4.52% |
| Premiums earned | $17,775,014 | 100.00% |

G. Accounts and Records

Annual Statement Schedule P Part 3E

It is noted that information provided by the Company in Schedule P Part 3E Column 12 of the 2004 filed annual statement for claims closed without payment was inaccurate. The National Association of Insurance Commissioners ("NAIC") annual statement instructions provide a guideline for the preparation of Schedule P to facilitate the reasonable estimate of the reserves for losses and loss adjustment expense. Consequently, it is recommended that the Company prepare Schedule P Part 3E Column 12 in accordance with the NAIC annual statement instructions.

## 3. FINANCIAL STATEMENTS

### A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2004, as determined by this examination and as reported by the Company:

| Assets | Assets | Examination Assets Not Admitted | Net Admitted Assets |
|---|---|---|---|
| Bonds | $6,539,417 | $0 | $6,539,417 |
| Preferred stocks | 100,500 | 0 | 100,500 |
| Common stocks | 1,166,007 | 0 | 1,166,007 |
| Properties occupied by the company | 668,550 | 0 | 668,550 |
| Cash, cash equivalents and short-term investments | 1,057,433 | 0 | 1,057,433 |
| Subtotals, cash and invested assets | $9,531,907 | $0 | $9,531,907 |
| Investment income due and accrued | 69,728 | 0 | 69,728 |
| Uncollected premiums and agents' balances in the course of collection | 216,969 | 478 | 216,491 |
| Deferred premiums, agents' balances and installments booked but deferred and not yet due | 988,416 | 2,178 | 986,238 |
| Amounts recoverable from reinsurers | 109 | 0 | 109 |
| Net deferred tax asset | 325,536 | 10,079 | 315,457 |
| Electronic data processing equipment and software | 5,350 | 5,350 | 0 |
| Furniture and equipment, including health care delivery assets | 89,807 | 89,807 | 0 |
| Other assets nonadmitted | 51,208 | 51,208 | 0 |
| Totals | $11,279,030 | $159,100 | $11,119,930 |

Liabilities, surplus and other funds

| | | |
|---|---|---|
| Losses and loss adjustment expenses | | $ 2,261,631 |
| Commissions payable, contingent commissions and other similar charges | | 208,755 |
| Other expenses (excluding taxes, licenses and fees) | | 28,366 |
| Taxes, licenses and fees (excluding federal and foreign income taxes) | | 8,808 |
| Current federal and foreign income taxes | | 10,000 |
| Unearned premiums | | 3,255,415 |
| Advance premiums | | 75,753 |
| Ceded reinsurance premiums payable (net of ceding commissions) | | 114,212 |
| Amounts withheld or retained by company for account of others | | 26,183 |
| Total liabilities | | $5,989,123 |
| Required surplus Aggregate write-ins for special surplus funds | 100,000 | |
| Unassigned funds (surplus) | 5,030,807 | |
| Surplus as regards policyholders | | $ 5,130,807 |
| Totals | | $11,119,930 |

Note: The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2000 through 2004. 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 increased $2,127,533 during the five-year examination period, January 1, 2000 through December 31, 2004, detailed as follows:

| | | |
|---|---|---|
| Underwriting Income | | |
| Premiums earned | | $17,775,014 |
| Deductions: | | |
| Losses and loss adjustment expenses incurred | $9,690,569 | |
| Other underwriting expenses incurred | 7,280,404 | |
| Total underwriting deductions | | 16,970,973 |
| Net underwriting gain or (loss) | | $804,041 |
| Investment Income | | |
| Net investment income earned | $1,604,201 | |
| Net realized capital gain | 63,298 | |
| Net investment gain or (loss) | | $1,667,499 |
| Other Income | | |
| Net gain or (loss) from agents' or premium balances charged off | $16,704 | |
| Finance and service charges not included in premiums | 389,397 | |
| Aggregate write-ins for miscellaneous income | 7,681 | |
| Total other income | | $413,782 |
| Net income before dividends to policyholders and before federal and foreign income taxes | | $2,885,322 |
| Net income after dividends to policyholders but before federal and foreign income taxes | | $2,885,322 |
| Federal and foreign income taxes incurred | | 1,010,149 |
| Net Income | | $1,875,173 |

Capital and Surplus

| | Gains in Surplus | Losses in Surplus | |
|---|---|---|---|
| Surplus as regards policyholders per report on examination as of December 31, 1999 | | | $3,003,274 |
| Net income | $1,875,173 | 0 | |
| Net unrealized capital gains or (losses) | 0 | $76,509 | |
| Change in net deferred income tax | $324,757 | 0 | |
| Change in nonadmitted assets | $9,863 | 0 | |
| Cumulative effect of changes in accounting principles | 0 | $5,751 | |
| Net increase (decrease) in surplus | | | $2,127,533 |
| Surplus as regards policyholders per report on examination as of December 31, | | | $5,130,807 |

## 4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of $2,261,631 is the same as the amount reported by the Company as of December 31, 2004. The examination analysis was conducted in accordance with generally accepted actuarial principles and was based on statistical information contained in the Company's internal records and in its filed annual statements.

## 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 it 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

Except as noted below, no unfair practices were encountered.

i. Maintenance of Complaint log

An examination comparison of the Company’s complaint log to the Department listing of complaints filed against the Company indicated that some complaints were missing from the Company’s log. Part 216.4(e) of the Department Regulation 64 requires that “an insurer's consumer services department shall maintain an ongoing central log to register and monitor all complaint activity.” In addition, the format of the Company's complaint log did not fully comply with the requirements set forth in Circular Letter 11 of 1978. Therefore, it is recommended that the Company comply with Part 216.4(e) of the Department Regulation 64 and Circular Letter 11 of 1978 and maintain a complaint log that registers and monitors all complaint activities in the format put forth by Circular Letter 11 of 1978.

ii. Department Regulation 90 (11NYCRR218)

The Company’s procedures for canceling agents’ agreements were reviewed whereupon it was determined that the Company was not following the requirements of this Department's Regulation No. 90 in all instances.

Part 218.4(b) of Regulation No. 90 requires that all notices to agents or brokers that their contract or account is to be terminated shall be mailed or delivered to the affected agent or broker at least 30 days prior to the effective date of such termination. It was found during this examination that some of the termination notices issued by the Company were not being mailed or delivered to the affected agent at least 30 days prior to the effective date of such termination. In one instance, it was found that the notice did not provide a specific reason for the termination of the agent. It is recommended that the Company comply with all of the requirements set forth in Part 218.4(b) of this Department's Regulation 90 when sending notices of termination of agents' contracts or accounts.

## 6. <u>COMPLIANCE WITH PRIOR REPORT ON EXAMINATION</u>

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

| ITEM | | PAGE NO. |
|---|---|---|
| A. | It was recommended that the Company disposed of its investment in a second Mortgage on real estate to comply with Section 1407 and 1412 of the New York Insurance Law. | 14 |

The Company has complied with this recommendation.

## 7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

| ITEM | | PAGE NO. |
|---|---|---|
| A. | Holding Company Matters | |
| | It is recommended that the Company comply with Section 308 of the NYIL and Circular Letter 17 of 2001 by filing transactions involving the Company and affiliates as prescribed by Article 15 of the NYIL. | 8 |
| B. | Accounts and Records | |
| | It is recommended that the Company prepare Schedule P Part 3E Column 12 in accordance with the NAIC annual statement instructions. | 10 |
| C. | Market Conduct | |
| | i. It is recommended that the Company comply with Part 216.4(e) of the Department Regulation 64 and Circular Letter 11 of 1978 and maintain a complaint log that registers and monitors all complaint activities in a format put forth by Circular Letter 11 of 1978. | 15 |
| | ii. It is recommended that the Company comply with all of the requirements set forth in Part 218.4(b) of this Department's Regulation 90 when sending notices of termination of agents' contracts or accounts. | 16 |

Respectfully submitted,

/S/

Nyantakyi Akuoko
Senior Insurance Examiner

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

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

/S/

Nyantakyi Akuoko

Subscribed and sworn to before me

this 7th day of JULY, 2006.

/S/

DIANNE M. BURKE
Notary Public, State of New York
Qualified in Albany County
No. 01BU5076509
Commission Expires April 21 2007

***Appointment No*** 22432

*STATE OF NEW YORK*
*INSURANCE DEPARTMENT*

*I,* Howard D Mills *, Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:*

**Nyantakyi Akuoko**

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

**Eastern Mutual 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 Albany,*

*this* 3rd *day of* November 05

STATE OF NEW YORK
SUPERINTENDENT OF INSURANCE
EXCELSIOR

Howard D. Mills
*Superintendent of Insurance*