

REPORT ON EXAMINATION
OF THE
CALLICOON CO-OPERATIVE INSURANCE COMPANY
AS OF
DECEMBER 31, 2004

DATE OF REPORT:

JULY 8, 2005

EXAMINER:

NYANTAKYI AKUOKO



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

George E. Pataki
Governor

Howard Mills
Superintendent

July 8, 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 instructions contained in Appointment Number 22358 dated April 6, 2005 hereto, I have made an examination into the condition and affairs of Callicoon Co-operative Insurance Company as of December 31, 2004, and submit the following report thereon.

Wherever the designations "the Company" or "CCIC" appear herein without qualification, they should be understood to indicate Callicoon Co-operative 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 office located at 15 Chapel Street, Jeffersonville, NY 12748

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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 those balance sheet items considered by this Department to require analysis, verification or description, including: invested assets, loss and loss adjustment expense reserves and 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

Callicoon Co-operative Insurance Company was organized on April 13, 1878 as Callicoon Agricultural Fire Relief Association of Sullivan County, New York for the purpose of transacting business as an assessment co-operative insurance association in Sullivan County in this State. Subsequently, the territorial limits were extended to cover all the counties in the State, excluding the counties of New York, Kings, Queens, Bronx and Richmond. In 1964, this

Department approved a change of name of the Association to the Callicoon Co-operative Insurance Company.

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 eleven nor more than eighteen members. The board meets four times during each calendar year. At December 31, 2004, the board of directors was comprised of the following thirteen members:

| <u>Name and Residence</u> | <u>Principal Business Affiliation</u> |
|---|---|
| Ruth K. Baxter Mountaindale, NY | Retired |
| Roger E. Bisland Glen Spey, NY | Insurance Agent |
| Philip Conaty Monticello, NY | Attorney |
| John K. Gempler Kenoza Lake, NY | Secretary/Treasurer, CCIC |
| Carol Lane Monticello, NY | Retired |
| William Lane Monticello, NY | Retired |
| Clarence Loucks Livingston Manor, NY | President, CCIC |
| Douglas Loucks Livingston Manor, NY | Correction officer |
| William B. Merrill Hurley, NY | Independent claim adjuster |
| Jeanne L. Smith Livingston Manor, NY | CCIC employee and insurance agent |
| Edward Sykes Callicoon, NY | Insurance Agent, Vice President of CCIC |
| Lee Titus Wallkill, NY | Insurance Agent |
| Harry L. Wilcox Roscoe, NY | Dairy farmer |

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 has an acceptable record of attendance.

Section 712(a) of the New York Business Corporation Law ("NYBCL") gives the authority to create committees of the board to the board of directors. During the period of the examination, the board did not appoint or approve membership to the Investment and Salary Committees. Therefore, it is recommended that the Company adhere to all the provisions of Section 712(a) of the NYBCL and have its board approve all appointments to board committees.

Section 1411(a) of the NYIL states, in part, that, "No domestic insurer shall make any loan or investment... unless authorized or approved by its board of directors or a committee thereof responsible for supervising or making such investment or loan. The committees' minutes shall be recorded and a report submitted to the board of directors at its next meeting."

During the review of the Company's investments to determine if they were properly approved, it was determined that the Company was not having its board approve of all of its investments. Thus, the Company was not complying with the requirements of Section 1411(a) of the NYIL. Therefore, it is recommended that the Company comply with Section 1411(a) of the NYIL and have all its investments approved by its board of directors.

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

| <u>Name</u> | <u>Title</u> |
|------------------|---------------------|
| Claurence Loucks | President |
| Edward Sykes | Vice President |
| John Gempler | Secretary/Treasurer |

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 New York Insurance Law ("NYIL"):

| <u>Paragraph</u> | <u>Line of Business</u> |
|------------------|--|
| 4 | Fire |
| 5 | Miscellaneous property |
| 6 | Water damage |
| 7 | Burglary and theft |
| 8 | Glass |
| 12 | Collision |
| 13 | Personal injury liability |
| 14 | Property damage liability |
| 15 | Worker's compensation and employer's liability (excluding workers' compensation) |
| 19 | Motor vehicle and aircraft physical damage |
| 20 | Marine and inland marine |

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 for the period under examination:

| <u>Calendar Year</u> | <u>Direct Premiums Written(000's)</u> |
|----------------------|---------------------------------------|
| 2000 | \$3,536 |
| 2001 | \$3,803 |
| 2002 | \$4,437 |
| 2003 | \$4,985 |
| 2004 | \$5,415 |

Based on the lines of business for which the Company is licensed and pursuant to the requirements of Article 66 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$100,000. The company underwrites predominantly commercial multiple peril, homeowners multiple peril and fire lines of business, which accounted for 46%, 35% and 11% respectively, of 2004 net 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) | \$625,000 excess of \$75,000 ultimate loss each risk, not exceeding \$225,000, \$600,000 and \$1,050,000 ultimate loss any one occurrence for each respective layer. In addition if a loss occurrence takes place which involves one or more risks/insureds/policies reinsured and under the First, Second and Third Casualty Excess of Loss Reinsurance Agreement \$20,000 excess of \$75,000 each such loss occurrence. |
| Casualty Lines(3 layers) | \$980,000 excess of \$20,000 ultimate net loss occurrence. In addition, if a loss occurrence takes place, which involves one or more risks/insureds/policies reinsured and under the First, Second and Third Property Excess of Loss \$20,000 excess of \$75,000 each such occurrence. |
| Casualty Clash | \$1,000,000 excess of \$1,000,000 per loss occurrence, not exceeding \$1,000,000 ultimate net losses in all, any one loss occurrence. |
| Property Catastrophe Excess of Loss(3 layers) | 95% of \$1,800,000 excess of \$200,000 each loss occurrence. 100% ultimate net loss in excess of \$2,000,000 |
| Aggregate Excess of Loss | 95% of \$750,000 of net losses, during the term of the contract, in excess of 86% of the net premium earned. |

In addition to its treaty reinsurance program the Company also obtained property facultative reinsurance coverage. The maximum cession for the program is \$500,000 liability, after maintaining \$600,000 maximum net and treaty retention. The reinsurer's limit in any one occurrence is \$1,000,000, plus the reinsurer's pro rata portion of loss expense.

Since the previous examination, the Company's retention has increased from \$30,000 to \$75,000 on property business and from \$15,000 to \$20,000 on casualty business.

In 2004 the Company, as an assessment co-operative insurer, ceded reinsurance to an unauthorized insurer without the approval of the Superintendent. Section 6606(a)(2) of the New York Insurance Law provides that an assessment co-operative insurer may cede reinsurance to any licensed insurer, unless otherwise permitted by the Superintendent. Therefore, it is recommended that the Company comply with Section 6606(a)(2) of the NYIL and obtain the permission of the Superintendent before ceding reinsurance to any unauthorized insurer.

During 2003 and 2004, the Company ceded more than 50% of its unearned premiums. In order to comply with the provisions of Section 1308(e)(1)(A) of the NYIL, the Company should have submitted its reinsurance agreements to the Department for review. During the course of the examination, the Company did submit such agreements to the Department. Nevertheless, it is recommended that the company comply with Section 1308(e)(1)(A) 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.

The examination review of the Schedule F data reported by the Company in its 2004 filed annual statement was not found to accurately reflect its reinsurance transactions. The Company ceded reinsurance to two reinsurers, but the Schedule F listed one company only. It is

recommended that the Company comply with the annual statement instructions and complete Schedule F with the accurate data that reflects its reinsurance transactions. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in paragraphs 25 and 26 of SSAP No. 62.

D. Holding Company System

As of December 31, 2004, the Company was not a member of any holding company system. The Company was independent with no affiliations or pooling agreements in force at December 31, 2004.

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 to be 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.

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 State Abandoned Property Law.

F. Significant Operating Ratios

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

| | |
|---|-----|
| Net premiums written to surplus as regards policyholders | 31% |
| Liabilities to liquid assets(cash and invested assets less investments in affiliates) | 21% |
| Premiums in course of collection to surplus as regards policyholders | 2% |

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 a 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 | \$ 7,658,038 | 50.95% |
| Other underwriting expenses incurred | 5,840,141 | 38.86% |
| Net underwriting gain | <u>1,531,907</u> | <u>10.19%</u> |
| Premiums earned | <u>\$15,030,086</u> | <u>100.00%</u> |

G. Accounts and Records

i. Annual Statement-Supplemental Compensation Exhibit

During the examination review of compensation paid to officers and employees, it was discovered that the Company did not include in the annual statement compensation exhibit commissions paid to officers and employees who also act as agents for the Company. It is

recommended that the Company comply with the annual statement instructions and include in the annual statement Supplemental Compensation Exhibit all compensation paid to officers and employees.

ii. Signature requirements

Section 6611(a)(4)(C) of the NYIL provides in part that all checks issued shall be signed either by two officers or one officer. During the review of the bank confirmation and the minutes of board meetings, it was discovered that two non-officer directors were listed as signatories on the Company's checking accounts. Consequently, it is recommended that the Company comply with Section 6611(a)(4)(C) of the NYIL regarding the signature requirements on checks.

iii. Circular Letter 13 of 1976

During the review of the custodial agreement between the Company and the custodian of its securities, it was noted that the agreement did not contain the language suggested by Circular Letter 13 of 1976. The Letter suggests the inclusion of a provision that the custodian be obligated to indemnify the insurer in the event of any loss of securities occasioned by the dishonesty of the bank officers and that the bank will not be held liable for any failure to take any action required to be taken in the event that the said action is prevented or delayed by war etc. Therefore, it is recommended that the Company comply with the Department Circular Letter 13 of 1976 and obtain a custodial agreement that will include the language put forth by the Circular Letter.

iv. Regulation 30

The report of the Company's time study used to allocate salaries to the annual statement expense group was not accompanied by written documentation to indicate the method used to perform the study. During the review of expense allocation, it was noted that some expenses were allocated to the wrong expense group. Therefore, it is recommended that management establish and maintain written documentation supporting time study on the allocation of salaries to the major expense groups in accordance with Regulation 30. Also, it is recommended that the Company allocate expenses to each expense category in accordance with Regulation 30.

3. FINANCIAL STATEMENTSA. 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:

| <u>Assets</u> | <u>Assets</u> | Examination Assets Not <u>Admitted</u> | Net Admitted <u>Assets</u> |
|---|----------------------|--|-------------------------------|
| Bonds | \$ 12,233,169 | \$0 | \$ 12,233,169 |
| Preferred stocks | 150,657 | 0 | 150,657 |
| Common stocks | 882,744 | 0 | 882,744 |
| Properties occupied by the company | 23,112 | 0 | 23,112 |
| Cash, cash equivalents and short-term investments | 1,936,316 | 0 | 1,936,316 |
| Investment income due and accrued | 154,004 | 0 | 154,004 |
| Uncollected premiums and agents' balances in the course of collection | 235,285 | 0 | 235,285 |
| Deferred premiums, agents' balances and installments booked but deferred and not yet due | 900,538 | 0 | 900,538 |
| Amounts recoverable from reinsurers | 177,953 | 0 | 177,953 |
| Totals | <u>\$ 16,693,778</u> | <u>\$0</u> | <u>\$ 16,693,778</u> |

Liabilities, surplus and other funds

| | | |
|---|-------------------|----------------------|
| Losses and loss adjustment expenses | | \$ 1,153,425 |
| Commissions payable, contingent commissions and other similar charges | | 170,373 |
| Unearned premiums | | <u>2,862,294</u> |
| Total liabilities | | 4,186,092 |
| Aggregate write-ins for special surplus funds | 100,000 | |
| Unassigned funds(surplus) | <u>12,407,686</u> | |
| Surplus as regards policyholders | | <u>\$ 12,507,686</u> |
| Totals | | <u>\$ 16,693,778</u> |

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 \$3,385,634 during the five-year examination period, January 1, 2000 through December 31, 2004, detailed as follows:

Underwriting Income

| | | |
|---|------------------|-------------------|
| Premiums earned | | \$15,030,086 |
| Deductions: | | |
| Losses and loss adjustment expenses incurred | \$7,658,038 | |
| Aggregate write-ins for underwriting deductions | <u>5,840,141</u> | |
| Total underwriting deductions | | <u>13,498,179</u> |
| Net underwriting gain or (loss) | | \$ 1,531,907 |

Investment Income

| | | |
|-------------------------------|-----------------|--------------|
| Net investment income earned | \$2,708,833 | |
| Net realized capital gain | <u>(14,578)</u> | |
| Net investment gain or (loss) | | \$ 2,694,255 |

Other Income

| | | |
|--|---------|---------------------|
| Finance and service charges not included in premiums | 150,297 | |
| Total other income | | \$ 150,297 |
| Net income before dividends to policyholders and before federal and foreign income taxes | | <u>\$ 4,376,459</u> |
| Net income after dividends to policyholders but before federal and foreign income taxes | | \$ 4,376,459 |
| Federal and foreign income taxes incurred | | <u>973,695</u> |
| Net Income | | <u>\$ 3,402,764</u> |

| | | | |
|--|------------------------|--------------------------|---------------------|
| Surplus as regards policyholders per report on examination as of December 31, 1999 | | | \$ 9,122,052 |
| | <u>Gain in Surplus</u> | <u>Losses in Surplus</u> | |
| Net income | \$ 3,402,764 | 0 | |
| Net unrealized capital gains or (loss) | <u>0</u> | <u>\$ 17,130</u> | |
| Net increase (decrease) in surplus | | | <u>\$ 3,385,634</u> |
| Surplus as regards policyholders per report on examination as of December 31, 2004 | | | <u>\$12,507,686</u> |

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items for \$1,153,425 is the same as reported by the Company as of December 31, 2004. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Companies internal records and in its filed annual statement.

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

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 review indicated the following findings and recommendations:

Cancellation/non-renewal of commercial and personal lines

During the review of cancelled and non-renewal policies, it was discovered that the stated reasons for cancellations/non-renewal of policies were not specific. Section 3425(d)(1) and 3426(e)(2) of the NYIL state in part that written notice "shall contain the specific reason and reasons for cancellation/non-renewals." Therefore, it is recommended that the Company comply with Sections 3425(d) (1) and 3426(e) (2) of the NYIL and provide more specific reasons for commercial and personal lines cancellations/non-renewals issued forthwith.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

| ITEM | PAGE NO. |
|---|----------|
| A. It was recommended that the board members who are unable or unwilling to attend meetings consistently should resign or be replaced | 4 |
| The Company has complied with this recommendation | |
| B. It was recommended that the Company followed the annual statement Instructions by including call options dates in future financial statement | 9 |
| The Company has complied with this recommendation. | |

| ITEM | PAGE NO. |
|--|----------|
| <p>C. It was recommended that the Company follow the NAIC Accounting Principles and Procedure Manual and annual statement instructions and calculate the amortization of securities on the callable date rather than maturity date, when necessary.</p> <p>The company complied with this recommendation, but with the adoption of Codification, this procedure was changed.</p> | 9 |
| <p>D. It is recommended that the Company follow the NAIC annual statement instructions and segregate premiums and agents balances in the course of collection into their proper categories when reporting on lines 10.1 and 10.2 of page 2 of future financial statements filed with this Department.</p> <p>The Company has complied with recommendation.</p> | 10 |
| <p>E. It was recommended that the Company, in response to General Interrogatory's # 9(c), have the written conflict of interest statements completed annually, with regard to directors, officers and responsible employees.</p> <p>The Company has complied with this recommendation.</p> | 10 |
| <p>F. It was recommended that the Company complied with Section 312(b) of the NYIL and retained a signed copy of the statement that each member of the board of directors received a copy of the examination report.</p> <p>The Company has complied with this recommendation</p> | 11 |

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

| <u>ITEM</u> | <u>PAGE NO.</u> |
|--|---------------------|
| A. <u>Management</u> | |
| i. It is recommended that the Company adhere to all the provisions of Section 712(a) of the NYBCL and have its board approve all appointments to board committees. | 4 |
| ii. It is recommended that the Company comply with Section 1411(a) of the NYIL and have all its investments approved by its board of directors. | 4 |
| B. <u>Reinsurance</u> | |
| i. It is recommended that the Company comply with Section 6606(a) (2) of the NYIL and obtain the permission of the Superintendent before ceding reinsurance to any unauthorized insurer. | 7 |
| ii. It is recommended that the company comply with Section 1308(e)(1)(A) of the NYIL . | 7 |
| iii. It is recommended that the Company comply with the annual statement instructions and complete Schedule F with the accurate data that reflects its reinsurance transactions. | 7-8 |
| C. <u>Accounts and Records</u> | |
| i. It is recommended that the Company comply with the annual statement instructions and include in the annual statement Supplemental Compensation Exhibit all compensation paid to officers and employees. | 9-10 |
| ii. It is recommended that the Company comply with section 6611(a)(4)(C) of the NYIL regarding the signature requirements on checks. | 10 |

| <u>ITEM</u> | <u>PAGE NO.</u> |
|--|-----------------|
| iii. It is recommended that the Company comply with the Department Circular Letter 13 of 1976 and obtain a custodial agreement that will include the language put forth by the Circular Letter. | 10 |
| iv. It is recommended that management establish and maintain written documentation supporting time study on the allocation of salaries into the major expense groups in accordance with Regulation 30. Also, it is recommended that the Company allocate expenses to each expense category in accordance with Regulation 30. | 11 |
| D. <u>Market Conduct</u> | |
| It is recommended that the Company comply with Sections 3425(d)(1) and 3425(e)(2) of the NYIL and provide more specific reasons for commercial and personal lines cancellations/non-renewal issued forthwith. | 16 |

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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 submitted is true to the best of his knowledge and belief.

151
Nyantakyi Akuoko

Subscribed and sworn to before me

this 22ND day of APRIL 2005

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

Appointment No 22358

*STATE OF NEW YORK
INSURANCE DEPARTMENT*

*I, Howard Mills, Acting 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

Callicoon Co-Operative Insurance Company

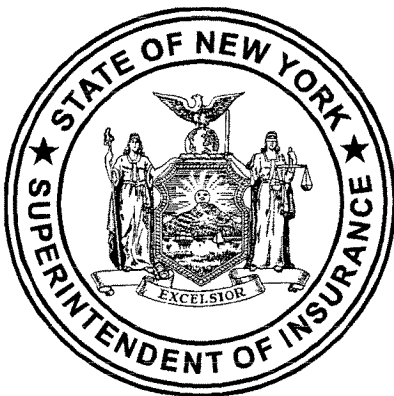
and to make a report to me in writing of the condition of the said

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 6th day of April 2005



Howard Mills
Acting Superintendent of Insurance