<u>REPORT ON EXAMINATION</u>

<u>OF THE</u>

<u>AMERICAN INDEPENDENT NETWORK INSURANCE COMPANY OF NEW YORK</u>

<u>AS OF</u>

<u>DECEMBER 31, 2002</u>

DATE OF REPORT	**JULY 1, 2004**
EXAMINER	**JOSEPH S. KRUG**

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

George E. Pataki
Governor

Gregory V. Serio
Superintendent

July 1, 2004

Honorable Gregory V. Serio
Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law and in compliance with instructions contained in Appointment Number 22097, dated October 15, 2003 and annexed hereto, I have made an examination into the condition and affairs of the American Independent Network Insurance Company of New York, an accident and health insurance insurer licensed under Article 42 of the New York Insurance Law, and submit the following report thereon.

The examination was conducted at the Company's main administrative office located at 3440 Lehigh Street, Allentown, PA 18105.

Wherever the designations "the Company" or "AINIC" appear herein without qualification, they should be understood to indicate the American Independent Network Insurance Company of New York.

1. SCOPE OF EXAMINATION

The previous examination, a Report on Organization, was made as of April 3, 1998. This examination covers the period from April 4, 1998 through December 31, 2002. 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, 2002, in accordance with Statutory Accounting Principles, as adopted by the New York Insurance Department, a review of income and disbursements deemed necessary to accomplish such verification and utilized, to the extent considered appropriate, work performed by the Company's independent certified public accountants. A review or audit was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners:

History of the Company
Management and control
Corporate records
Fidelity bonds and other insurance
Officers' and employees' welfare and pension plans
Territory and plan of operation
Growth of company
Business in force
Loss experience
Accounts and records
Treatment of policyholders and claimants

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

American Independent Network Insurance Company of New York was incorporated on April 9, 1997. The Company is a wholly owned subsidiary of Penn Treaty American Corporation (PTA), an insurance holding company. The Company is licensed under Article 42 of the New York Insurance Law to write accident and health insurance in New York. Its principal lines of business are long-term care and home health care products.

A. Management

Pursuant to AINIC's charter and by-laws, management of the Company is vested in a board of directors consisting of thirteen members. The board meets four times during the calendar year. At December 31, 2002, the directors of the Company were as follows:

Name and Residence	Principal Business Affiliation
Todd B. Armstrong, Schnecksville, PA	Vice President of Underwriting, American Independent Network Insurance Company of New York
Jack D. Baum, Macungie, PA	Vice President, American Independent Network Insurance Company of New York
A. J. Carden, Allentown, PA	Executive Vice President, American Independent Network Insurance Company of New York
Alex Clark, New York, NY	Managing Director, Advest, Inc.
Elaine P. Fuchs, Palm Springs, CA	Retired
Michael F. Grill, Royersford, PA	Treasurer, American Independent Network Insurance Company of New York
Lawrence N. Hausman, Plymouth Meeting, PA	Vice President, Policyholders Services American Independent Network Insurance Company of New York
James M. Heyer, Schnecksville, PA	Senior Vice President, American Independent Network Insurance Company of New York
Matthew W. Kaplan, Marina Del Rey, CA	Managing Director, Oakbridge Capital Partners, LLC
Irving Levit, Macungie, PA	Chairman of the Board and CEO, American Independent Network Insurance Company of New York
Kimberly R. Levit-Valuntas, Allentown, PA	Insurance Agent
Joseph K. Valuntas, Brooklyn, NY	Consultant, Self-employed.
Cameron B. Waite, Pennsburg, PA	Executive Vice President and Chief Financial Officer, American Independent Network Insurance Company of New York

The minutes of all meetings of the Board of Directors and committees thereof held during the examination period were reviewed. All such meetings were well attended.

It was noted that the Company has not been distributing annual conflict of interest statements to its officers and directors since its organization in 1998. This was brought to the attention of Company management which indicated that the Company would require that officers and directors complete conflict of interest statements annually in the future.

It is recommended that the Company distribute annual conflict of interest statements to its officers and directors and require that the Company's officers and directors complete such statements annually in the future.

The Company's principal officers, at December 31, 2002, were as follows:

Name	**Title**
Irving Levit	Chief Executive Officer
William Walter Hunt	President
Sandra Ann Kotsch	Secretary
Michael Francis Grill	Treasurer

B. Territory and Plan of Operation

AINIC was licensed, as of December 31, 2002, to transact an accident and health insurance business as defined by Section 1113(a)(3)(i) of the New York Insurance Law.

The Company writes business in New York State only. In 2002, the Company wrote total direct premiums in the amount of $3,877,469.

The following chart depicts the membership of its subscribers at each year-end:

	1998	1999	2000	2001	2002
Number of subscribers	20	366	1,415	1,734	1,791

Based upon the line of business for which the Company is licensed, and pursuant to the requirements of Articles 13 and 42 of the New York Insurance Law, the Company is required to maintain minimum capital of $300,000.

The Company used the services of independent brokers and agents during the period under examination.

C. Investments

During the review of investments it was noted that the Company was not conforming to the Investment Section of the Commitment Letter, dated July 3, 1997, entered into between the Company and the Superintendent of Insurance. This agreement outlines the Criteria and Guidelines for Domestic Accident and Health Companies. Specifically, the letter addresses the performance of daily operations of AINIC, including but not limited to administration, underwriting, claims, policyholder services, investments, record keeping, accounting and reinsurance.

The Commitment Letter states in part:

> "All of American's securities and investments, (except as may be necessary to meet current obligations in other jurisdictions), its bank accounts (except as may be necessary to meet obligations in other jurisdictions in which the domestic insurer may be licensed), and evidence of asset ownership, must be located in New York."

During the examination period, the Company's investments were located in the Commonwealth of Pennsylvania rather than New York State.

It is recommended that all of the Company's securities and investments, its bank accounts and evidence of asset ownership be located in New York State as per the Commitment Letter which the Company entered into with the Superintendent of Insurance.

Furthermore, it was noted that the purchase and sale of the Company's investments were not approved by its board of directors. Section 1411(a) of the New York Insurance Law states:

> "No domestic insurer shall make any loan or investment...unless authorized or approved by its board of directors or a committee thereof responsible for the supervising or making such investment or loan."

It is recommended that the purchase and sale of investments be approved by AINIC's board of directors.

D. **Reinsurance**

A review was conducted of the two quota share reinsurance treaties that the Company had in place during the examination period. Treaty A294-001-000 is with Cologne Life Re of America while Treaty A294-002-000 is with General & Cologne Life Re of America. Both of these reinsurers are unauthorized companies. No reinsurance amounts were due AINIC as of December 31, 2002. It should be noted that both of these treaties have been terminated effective June 30, 2001 and have not been replaced. Renewal policies that were in effect prior to the termination date are still covered under both agreements. Both treaties contained the required insolvency clause.

The following is a summary of the plans covered and benefits reinsured by policy type as of December 31, 2002:

1. **Treaty A294-001-000 with Cologne Life Re of America.**

Policies Reinsured.

PF2600 and related riders other than nonforfeiture options
FPF2600 and related riders other than nonforfeiture options

Retention Amount. The first $250,000 of benefits paid after the elimination period of the policy has been satisfied shall be retained by the Company.

Quota Share. 100% of benefits in excess of the retention amount.

Basis of Reinsurance. The Company shall cede to Cologne Life Re of America direct business underwritten on United States residents for automatic acceptance of health insurance subject to the limits and conditions below.

a. Benefit Limits.

$300 per day

2. **<u>Treaty A294-002-000 with General & Cologne Life Re of America.</u>**

Policies Reinsured.

26 Policy forms

Retention Amount. $350,000 retention on policies with benefit maximums in dollars
60 month retention on policies with benefit maximums in months

Quota Share. 100% of benefits in excess of the retention amount.

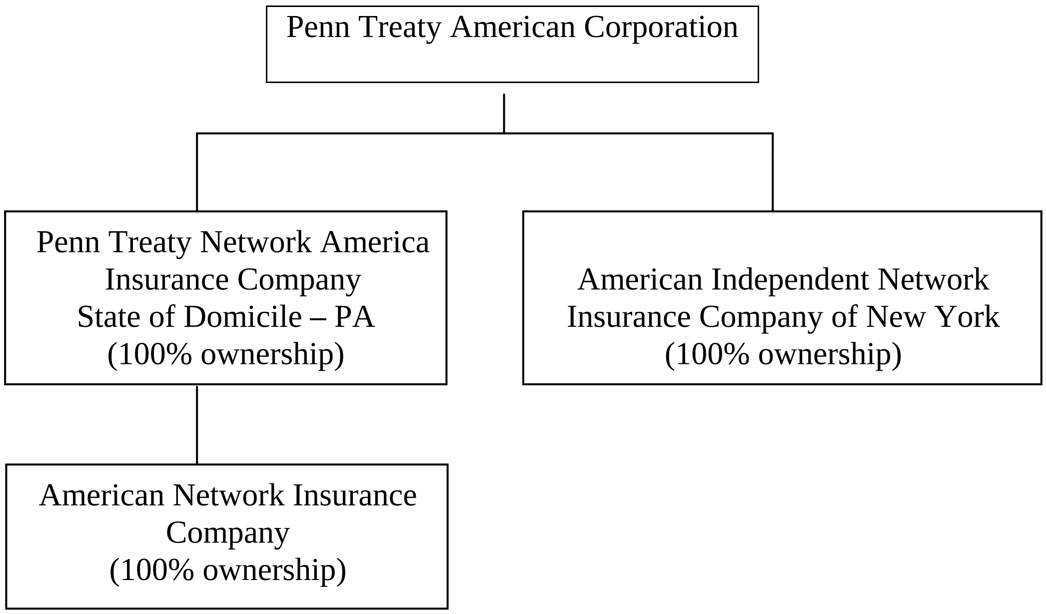
Basis of Reinsurance. The Company shall cede to GCL direct business underwritten on United States residents for automatic acceptance of health insurance subject to the limits and conditions below.

a. <u>Benefit Limits</u>.

$300 per day

E. **Holding Company System**

The following chart shows the relationship between the Company and its affiliates:



American Independent Network Insurance Company of New York, (the Company) is 100% owned by Penn Treaty American Corporation (PTA), an insurance holding company. PTA also owns 100% of Penn Treaty Network America Insurance Company (PTNA). PTNA owns 100% of American Network Insurance Company (ANIC). Both PTNA and ANIC are affiliates of the Company.

The examiner reviewed the Company filings required by Article 15 and Regulation 52. It was determined that the Company was in compliance with those requirements.

The following is a description of the inter-company agreements in effect as of the examination date:

i. Data Processing Cost Sharing Agreements

On January 1, 1998, the Company entered into a data processing cost sharing agreement with Penn Treaty Network America Insurance Company (PTNA). Under this agreement, approved by this Department, various services are provided by PTNA to AINIC, including, but not limited to management information systems, utilization review services, claims administration, marketing, collection of premiums, and review of staffing and scheduling.

ii. Claims Administration Cost Sharing Agreement

On January 1, 1998, the Company entered into a claims administration cost sharing agreement with Penn Treaty Network America Insurance Company (PTNA). Under this agreement, PTNA agrees to provide claims administration services to AINIC. The charges for the services rendered by PTNA are intended to represent the actual cost incurred by PTNA so that PTNA will neither profit nor suffer a loss. All charges and expenses directly incurred by PTNA on behalf of AINIC during each calendar are charged entirely to AINIC. Furthermore, AINIC is to reimburse PTNA for its share of the salaries, employee relations and welfare, travel and travel items, rent and rent items, equipment, telephone and telefax, and payroll tax expenses paid by PTNA. The parties acknowledged that the allocation method for shared expenses shall be consistent with the provisions of New York Insurance Department Regulation 33 (11 NYCRR 91). It is noted that the New York State Insurance Department has approved this agreement.

iii. Underwriting Cost Sharing Agreement

On January 1, 1998, the Company entered into an underwriting cost sharing agreement with Penn Treaty Network America Insurance Company (PTNA). Under this agreement, all underwriting services provided to AINIC are to be based on the written criteria, standards and guidelines of AINIC. However, AINIC has the ultimate and final authority over the acceptance, rejection or cancellation of risks. The charges to be paid by AINIC for the services rendered by PTNA are intended to represent the actual cost incurred by PTNA so that PTNA will neither receive a profit nor suffer a loss. All charges and expenses directly incurred by PTNA on behalf of AINIC during each calendar quarter under this agreement are charged entirely to AINIC. Furthermore, AINIC shall reimburse PTNA for its share of the salaries, employee relations and welfare, travel and travel items, rent and rent items, equipment, telephone and telefax, and payroll tax expenses paid by PTNA. The parties acknowledged that the allocation method for shared expenses shall be consistent with the provisions of New York Insurance Department Regulation 33 (11 NYCRR 91). It is noted that the New York State Insurance Department has approved this agreement.

During the review, it was determined that the Company did not comply with the provisions of said agreements relative to the methods of cost allocation as specified in Department Regulation 33 (11 NYCRR 91). Item 5 of the Data Processing Cost Sharing Agreement states "The parties hereto acknowledge that the allocation method for shared expenses shall be consistent with the provisions of New York Regulation 33." It was noted that during 2001 and 2002, the Company's affiliate, Penn Treaty Network America Insurance Company charged $100,000 of general expenses to the Company without adequate supporting documentation for such charge. This is a direct violation of Department Regulation 33 (11 NYCRR 91) which states that insurers are to use only such methods of allocation that will produce suitable and equitable distribution of income and expenses. Furthermore, Department Regulation 33 (11 NYCRR 91) requires

"each insurer to maintain records with sufficient detail to show fully:

(i) the system actually used for allocation of income and expenses;

(ii) the actual bases of allocation;

(iii) the actual monetary distribution of the respective items of income, salaries, wages, expenses and taxes to:

(a) units of activity or functions, if any distribution is made on such basis,

(b) fund accounts, if any distribution is made on the basis thereof, reflecting separately, for each fund, premiums or considerations, investment income, capital gains and losses, benefit payments, expenses and provision for reserves,

(c) annual statement lines of business,

(d) companies, and

(e) a recapitulation and reconciliation of items (a), (b), (c), and (d) with the insurer's books of account and annual statement,

(3) Such records shall be classified and indexed in such form as to permit ready identification between the item allocated and the basis upon which it was allocated, and shall be maintained in such manner as to be readily accessible for examination. These records shall bear the date and shall identify the person responsible for the preparation thereof.

(4) Bases of allocation shall be reviewed periodically to ascertain their suitability for continued use.

(5) Allocations of income and expenses between companies shall be treated in the same manner as if made for major annual statement lines of business".

It is recommended that the allocation of expenses between the Company and PTNA be apportioned in conformity with the provisions of Department Regulation 33 (11 NYCRR 91).

F. Abandoned Property Law

The examiner reviewed the Company's compliance with Section 1316 of the Abandoned Property Law and its filings thereunder with the Office of the Comptroller of the State of New York. The review indicated that the Company was not filing the required reports with such office. It was noted that a relatively small amount of money was due the Office of the Comptroller during the examination period that had not been paid as of the examination date.

It is recommended that the Company file annual reports with the Office of the Comptroller of the State of New York in compliance with Section 1316 of the Abandoned Property Law.

G. Disaster Recovery/Business Continuity Plan

It was noted that, at December 31, 2002, the Company did not maintain a disaster recovery plan nor a business continuity plan. Such plans are essential to the maintenance of continuity of services to the Company's policyholders in the event of a disaster or other contingency.

It is recommended that the Company develop and maintain both a disaster recovery and a business continuity plan.

H. Significant Operating Ratios

The following ratios have been computed as of December 31, 2002, based upon the results of this examination:

Net premiums written in 2002 to Surplus as regards policyholders	0.74 to 1
Liabilities to Liquid assets (cash and invested assets less investments in affiliates)	50.3%
Premiums in course of collection to Surplus As regards policyholders	0.0006%

The above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

3. FINANCIAL STATEMENTS

A. Balance sheet

The following shows the assets, liabilities and capital and surplus as determined by this examination and as reported by the Company as of December 31, 2002:

		Examination			
Assets	Assets	Nonadmitted Assets	Net Admitted Assets	Company	Change
Bonds	$7,438,048		$ 7,438,048	$ 7,438,048	
Cash and short term investments	2,679,344		2,679,344	2,679,344	
Federal and foreign income tax recoverable	293,276	223,654	69,622	69,622	
Accident and health premiums due and unpaid	3,278		3,278	3,278	
Investment income due and accrued	89,490		89,490	89,490	
Amounts due from agents	13,559	13,559	0	0	
Furniture and equipment	4,115	4,115	0	0	
Prepaid expense	57,562	57,562	0	0	
Total Assets	$10,578,672	$298,890	$10,279,782	$10,279,782	
Liabilities					
Aggregate reserve for accident and health Policies			$4,524,052	$3,736,318	$ 787,734
Policy and contract claims			404,092	404,092	
Interest Maintenance Reserve			61,285	61,285	
Commissions to agents due or accrued			983	983	
General expenses due or accrued			15,230	15,230	
Taxes, licenses, and fees due or accrued (excluding federal income taxes)			(3,895)	(3,895)	
Amounts held for agents' account			50,626	50,626	
Remittances and items not allocated			15,341	15,341	
Asset valuation reserve			11,986	11,986	
Reinsurance payable			10,189	10,189	
Total liabilities			$5,089,889	$4,302,155	$ 787,734
Capital and Surplus					
Common Capital Stock			$ 300,000	$ 300,000	
Gross Paid in and contributed surplus			5,600,141	5,600,141	
Unassigned funds			(710,248)	77,486	$(787,734)
Total capital and surplus			$5,189,893	$ 5,977,627	$(787,734)
Total liabilities, capital and surplus			$10,279,782	$10,279,782	

The Internal Revenue Service has not conducted any audits of the income tax returns filed on behalf of the Company through tax year 2002. The examiner is unaware of any potential exposure of the Company to any tax assessments and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus decreased $710,248 during the period from April 4, 1998 to December 31, 2002, detailed as follows:

Premiums and annuity considerations	$11,089,608
Net investment income	1,668,154
Amortization of interest maintenance reserve	16,719
Commissions and expense allowances on reinsurance ceded	29,710
Total	$12,804,191
Disability benefits and benefits under accident and health contracts	$ 1,598,955
Increase in aggregate reserves for life and accident and health contracts	4,524,052
Total	6,123,007
Commissions on premiums, annuity considerations and deposit-type funds	4,148,893
General insurance expenses:	1,549,608
Insurance taxes, licenses and fees, excluding federal income taxes	285,067
Total	$12,106,575
Net gain from operations before dividends to policyholders and federal income taxes	$ 697,616
Dividends to policyholders	0
Net gain from operations after dividends to policyholders and before federal income taxes	$ 697,616
Federal income taxes incurred	709,062
Net gain from operations after dividends to policyholders and federal income taxes and before realized gains and losses	$ (11,446)
Net realized capital gains or (losses) less capital gains tax and transferred to IMR	(22,754)
Net income	$ (34,200)

Surplus Account

	Gain in Surplus	Loss in Surplus	
Capital and surplus, per report on organization, April 3, 1998			$5,900,141
Net income	$	$ (34,200)	
Change in deferred income tax	97,780		
Change in non-admitted assets and related items		(298,890)	
Change in asset valuation reserve		(11,986)	
Cumulative effects of changes in accounting principles	188,048		
Dividends to stockholders		(651,000)	
Total	$285,828	(996,076)	
Net decrease in surplus			(710,248)
Capital and surplus, per report on examination, December 31, 2002			$5,189,893

4. ACCIDENT AND HEALTH – POLICY AND CONTRACT CLAIMS

The examination liability of $4,524,052 is $787,734 greater than the $3,736,318 reported by the Company as of the examination date. 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. The above change relates solely to the establishment of a premium deficiency reserve herein. The Company reported no liability under this component caption as of the examination date. The examination has established the captioned liability component in the amount of $787,734.

The Company established Contract Reserves by using net premium valuation. However, in instances where the net premiums are lower than the gross premiums remitted by policyholders, both the Statement of Statutory Accounting Principles Number 54 and the Actuarial Standards of Practice Number 42, call for setting up premium deficiency reserves for the differences. As previously stated, AINIC does not set up such premium deficiency reserves. AINIC's test of net premiums versus gross premiums is conducted in the aggregate, leading to an adjustment for premium deficiency reserves at $0. This process should be applied on a policy by policy basis. Using such process, the adjustment for premium deficiency reserves amounts to $787,734.

It is recommended that AINIC calculate its premium deficiency reserves on a policy by policy basis rather than on an aggregate basis.

5. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business practices and fulfills its contractual obligations to subscribers and claimants. The review was general in nature and is not to be construed to encompass the more precise scope of a market conduct examination.

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

A) Sales and advertising
B) Underwriting and rating
C) Treatment of subscribers and claimants

No problem areas were encountered during the review.

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

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Respectfully submitted,

Joseph S. Krug
Joseph S. Krug
Associate Insurance Examiner

STATE OF NEW YORK)
)SS
)
COUNTY OF MONROE)

Joseph S. Krug, being duly sworn, deposes and says that the foregoing report submitted by him is true to the best of his knowledge and belief.

Joseph S. Krug
Joseph S. Krug

Subscribed and sworn to before me
this 30th day of August 2005

Jamie L. Hodges
JAMIE L. HODGES
Notary Public in the State of New York
MONROE COUNTY
Commission Expires April 30, 2006

Appointment No. *22097*

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:

Joseph Krug

as a proper person to examine into the affairs of the

American Independent Insurance Company of New York

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

Company

with such information as he shall deem requisite.

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

this *15th* day of *October 2003*

Gregory V. Serio
Superintendent of Insurance