

REPORT ON EXAMINATION

OF

COMMERCIAL TRAVELERS MUTUAL INSURANCE COMPANY

AS OF

SEPTEMBER 30, 2013

DATE OF REPORT

FEBRUARY 9, 2015

EXAMINER

PEARSON GRIFFITH

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NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Benjamin M. Lawsky
Superintendent

February 9, 2015

Honorable Benjamin M. Lawsky
Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law and acting in accordance with the instructions contained in Appointment Numbers 30950, dated March 6, 2013, attached hereto, I have made an examination into the condition and affairs of Commercial Travelers Mutual Insurance Company, an accident and health insurer licensed pursuant to the provisions of Article 42 of the New York Insurance Law, as of September 30, 2013. The following report is respectfully submitted thereon.

The examination was conducted at the home office of Commercial Travelers Mutual Insurance Company located at 70 Genesee Street, Utica, New York and the home office of National Guardian Life Insurance Company located at 2 East Gilman Street, Madison, Wisconsin.

Wherever the designations "CTMIC" or the "Company" appear herein, without qualification, they should be understood to indicate Commercial Travelers Mutual Insurance Company.

Wherever the designation “NGLIC” appears herein, without qualification, it should be understood to indicate the National Guardian Life Insurance Company. As discussed further herein under item 2D, “Affiliation with NGLIC,” CTMIC entered into an affiliation agreement with National Guardian Life Insurance Co. (“NGLIC”), a Wisconsin-domiciled mutual life insurer. NGLIC representatives hold a majority of the positions on CTMIC’s board of directors.

Wherever the designation the “Department” appears herein, without qualification, it should be understood to indicate the New York State Department of Financial Services.

1. SCOPE OF THE EXAMINATION

The prior examination was conducted as of December 31, 2009. This examination of the Company was a financial examination as defined in the National Association of Insurance Commissioners (“NAIC”) *Financial Condition Examiners Handbook* (the “Handbook”) and covered the period from January 1, 2010 through September 30, 2013. The examination was conducted observing the guidelines and procedures in the Handbook. Where deemed appropriate by the examiner, transactions occurring subsequent to September 30, 2013 were also reviewed.

The examination was conducted on a risk-focused basis in accordance with the provisions of the Handbook, which provides guidance for the establishment of an examination plan based on the examiner’s assessment of risk in the Company’s operations and utilizes that evaluation in formulating the nature and extent of the examination. The examiner planned and performed the examination to evaluate the Company’s current financial condition, as well as to identify prospective risks that may threaten the future solvency of CTMIC.

The examiner identified key processes, assessed the risks within those processes and assessed the internal control systems and procedures used to mitigate those risks. The examination also included an assessment of the principles used and significant estimates made by management, an evaluation of the overall financial statement presentation, and determined management’s compliance with the Department’s statutes and guidelines, Statutory Accounting Principles, as adopted by the Department, and NAIC Annual Statement Instructions.

Information concerning the Company’s organizational structure, business approach and control environment were utilized to develop the examination approach. The examination

evaluated the Company's risks and management activities in accordance with the NAIC's nine branded risk categories. These categories are as follows:

- Pricing/Underwriting
- Reserving
- Operational
- Strategic
- Credit
- Market
- Liquidity
- Legal
- Reputational

The Company was audited for the years 2010 and 2011 by the accounting firm of BKD, LLP ("BKD"), and for the years 2012 and 2013 by the accounting firm of Ernst & Young, LLP ("E&Y"). E&Y was also appointed as auditors for 2014. The Company received an unqualified opinion in each of those years. Certain audit workpapers of BKD and E&Y were reviewed and relied upon in conjunction with this examination. A review was also made of the Company's Internal Audit function and Enterprise Risk Management program.

The examiner reviewed the corrective actions taken by the Company with respect to the financial comments and recommendations contained in the prior report on examination. The results of the examiner's review are contained in Item Five of this report.

A concurrent market conduct examination was conducted as of September 30, 2013 to review the manner in which the Company conducted its business practices and fulfilled its contractual obligations to policyholders and claimants. A separate market conduct report will be issued thereon.

This report on examination is confined to financial statements and comments on those matters which involve departures from laws, regulations or rules, or which require explanation or description.

2. DESCRIPTION OF THE COMPANY

The Company was incorporated as “Commercial Travelers Mutual Accident Association of America,” a cooperative assessment health plan, under the Laws of New York, and commenced business on March 30, 1883. The Company’s name was shortened to “The Commercial Travelers Mutual Accident Association” on May 22, 1953. Operations were conducted under the cooperative assessment plan until February 16, 1970. On that date, the Company re-incorporated to become a mutual accident and health insurance company. Concurrent with this change, the present Company name was adopted. The Company is licensed under Article 42 of the New York Insurance Law to write Accident and Health insurance as defined in New York Insurance Law, Section 1113(a)(3).

On May 6, 1988, a merger was effected between the Company and InterAmerica Consolidated Mutual Insurance Company of La Grange, Illinois, whereby the assets of the two entities were accounted for as a pooling of interest. Commercial Travelers Mutual Insurance Company was the surviving corporation.

As discussed further herein under item 2D, “Affiliation with NGLIC,” CTMIC entered into an affiliation agreement with National Guardian Life Insurance Co. (“NGLIC”), a Wisconsin-domiciled mutual life insurer. NGLIC representatives hold a majority of the positions on CTMIC’s board of directors.

A. Corporate Governance

Sections 1206(a)(3) and (6) of the New York Insurance Law state in part:

“Any domestic insurance corporation may amend its charter as follows:

(3) Upon the filing in the office of the superintendent of any certificate of change, amendment, or restated charter under any provision of law, with his approval endorsed thereon, the superintendent shall certify a copy thereof for filing in the office of the clerk of the county where the corporation's principal office is located and may grant it a license conforming to such change...

(6) It may make any other change in conformity with law, which shall be effective upon the filing of the certificate thereof in the office of the superintendent with his approval endorsed thereon.”

In addition, Section 1209(d) of the New York Insurance Law states in part:

“...No by-law or amendment or repeal of a by-law of any domestic mutual insurance corporation shall be effective until approved by the superintendent...”

During the review of corporate records, the examiner noted that the Company effected an amendment to its charter on November 4, 2011 to change the composition of the board from thirteen (13) members to not less than seven (7) nor more than thirteen (13) members. Such amendment was approved by the Department on November 23, 2011. However, the Company failed to file the amendment with the County Clerk's office.

The Company also effected an amendment to its charter on April 23, 2012, to change the required minimum of directors that are residents of New York from three (3) to one (1). Such amendment was neither submitted to the Superintendent for approval nor filed with the County Clerk's office. Furthermore, the Company amended its by-laws on June 12, 2012, to change certain provisions, also without submission to and the approval of the Superintendent.

The examiner notes that because these changes to the Company's charter and by-laws were not approved by the Department, they are deemed invalid. The charter and by-laws that were most

recently approved by the Department were so approved on April 8, 2005. Under those requirements, management of the Company was to be vested in a board of directors consisting of thirteen (13) members. The board of directors was comprised of nine (9) members as of September 30, 2013, as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Mathew J. Dew III * Madison, Wisconsin	Vice President, General Counsel, and Corporate Secretary, National Guardian Life Insurance Company
Philip W. Grece III Oriskany Falls, New York	Senior Vice President, Commercial Travelers Mutual Insurance Company
Brian J. Hogan Fitchburg, Wisconsin	Senior Vice President and Chief Financial Officer, National Guardian Life Insurance Company
Harrison J. Hummel III Mohawk, New York	President and Chief Executive Officer, Hummel's Office Plus
John D. Larson Madison, Wisconsin	Chairman of the Board, National Guardian Life Insurance Company
Robert A. Mucci Madison, Wisconsin	Senior Vice President, Treasurer and Director of Corporate Services, National Guardian Life Insurance Company
Alan L. Shulman Utica, New York	Vice President, Actuary and Assistant Corporate Secretary, Commercial Travelers Mutual Insurance Company
Mark L. Solverud Middleton, Wisconsin	President and Chief Executive Officer, Commercial Travelers Mutual Insurance Company
Denis J. Tauscheck Sun Prairie, Wisconsin	Senior Vice President and Chief Actuary, National Guardian Life Insurance Company

*Mathew J. Dew III was replaced by Kimberly Shaul, effective January 2014.

It is recommended that the Company comply with the provisions of Sections 1206(a)(3) and (6) and 1209(d) of the New York Insurance Law by obtaining the Superintendent's approval prior to implementing changes to its charter and/or by-laws and subsequently file such changes with the County Clerk.

Subsequent to the examination date, on January 28, 2014, the Company submitted the above-mentioned amendments to its charter and by-laws to the Department for approval. Such amendments to the charter and by-laws were approved by the Superintendent on March 25, 2014, and placed on file with the County Clerk's office on April 14, 2014.

The Company's board is required to meet once for an annual meeting and for three additional regular meetings during each calendar year but may hold special meetings as desired. CTMIC's board of directors met twenty-two (22) times during the period January 1, 2010 through October 23, 2013. A review of the minutes of the board of directors' meetings indicated that board meetings were generally well attended, with all members attending at least one-half of the meetings they were eligible to attend.

Section 1411(a) of the New York Insurance Law states in part:

“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 committee's minutes shall be recorded and a report submitted to the board of directors at its next meeting.”

A review of the board minutes for July 2013 indicated that the board of directors opted to approve, once a year, investment actions taken by the Company's management. The examiner determined that the authorization and approval of investment transactions on no less than a quarterly basis ensures the Company's compliance with the provisions of Section 1411(a) of the

New York Insurance Law as the Company files financial statements with the Department on a quarterly basis. The examiner further noted that there was no board approval of investment transactions during the period April 2013 through October 2013.

It is recommended that the Company and its board comply with the provisions of Section 1411(a) of the New York Insurance Law by authorizing and approving investments on at least a quarterly basis, and by recording such approvals in the minutes of the board of directors.

The principal officers of CTMIC as of September 30, 2013, were as follows:

<u>Name</u>	<u>Title</u>
Mark L. Solverud	President and Chief Executive Officer
Philip W. Grece III	Senior Vice President
Mathew J. Dew III *	General Counsel and Corporate Secretary
Derek J. Metcalf	Chief Financial Officer and Treasurer
Thomas P. Moore	Vice President and Director of Underwriting
Alan L. Shulman	Vice President, Actuary and Assistant Corporate Secretary
Brian T. Stalder	Vice President and Director of Marketing
Jeryl A. Olsen	Compliance Officer
Nickolas Ortner	Appointed Actuary
Vincent M. Pugliese	Director of Information Technology
Matthew J. Shedd	Director of Policy Administration

*Mathew J. Dew III was replaced by Kimberly Shaul, effective January 2014.

A review of corporate records indicated that the Company maintained a Code of Ethics policy and required its board members, officers and key employees to sign such Code of Ethics policy upon being hired. During the examination period, the examiner noted that Conflict of Interest Statements were distributed and signed by board members, officers and key employees on an annual basis.

B. Territory and Plan of Operation

Commercial Travelers Mutual Insurance Company is a mutual accident and health insurer licensed under the provisions of Article 42 of the New York Insurance Law. As of September 30, 2013, the Company was licensed to issue coverage in 49 states and the District of Columbia. However, the Commonwealth of Virginia, by order dated November 4, 2013, and the State of Washington, by order dated April 1, 2013, suspended the Company's certificates of authority to write business due to the Company's impaired status with regard to these States' minimum surplus requirements. In addition, the Company ceased writing new business in the States of Florida, Michigan, and Ohio, but is permitted to renew existing business. On July 14, 2014, the State of Washington removed the suspension from CTMIC's certificate of authority to write business, and on September 5, 2014, the Commonwealth of Virginia removed the suspension from CTMIC's certificate of authority to write business.

The Company's primary lines of business include college student medical expense, K-12 student accident-only medical expense, and disability income for small employers. Special risk group accident and medical expense, which provides medical expense coverage for non-student youth sports and youth/adult special activities, is also offered.

Based upon the capital requirements specified by Sections 1113(a)(3) and 4208 of the New York Insurance Law, the Company is required to maintain a minimum surplus in the amount of \$150,000.

The company's Risked-Based Capital ratio declined significantly during the examination period; from 596% in 2009 to 234% in 2011. This condition was the result of surplus declines that

resulted from losses produced by the student accident and health business, increased unfunded pension liabilities, and below average investment performance.

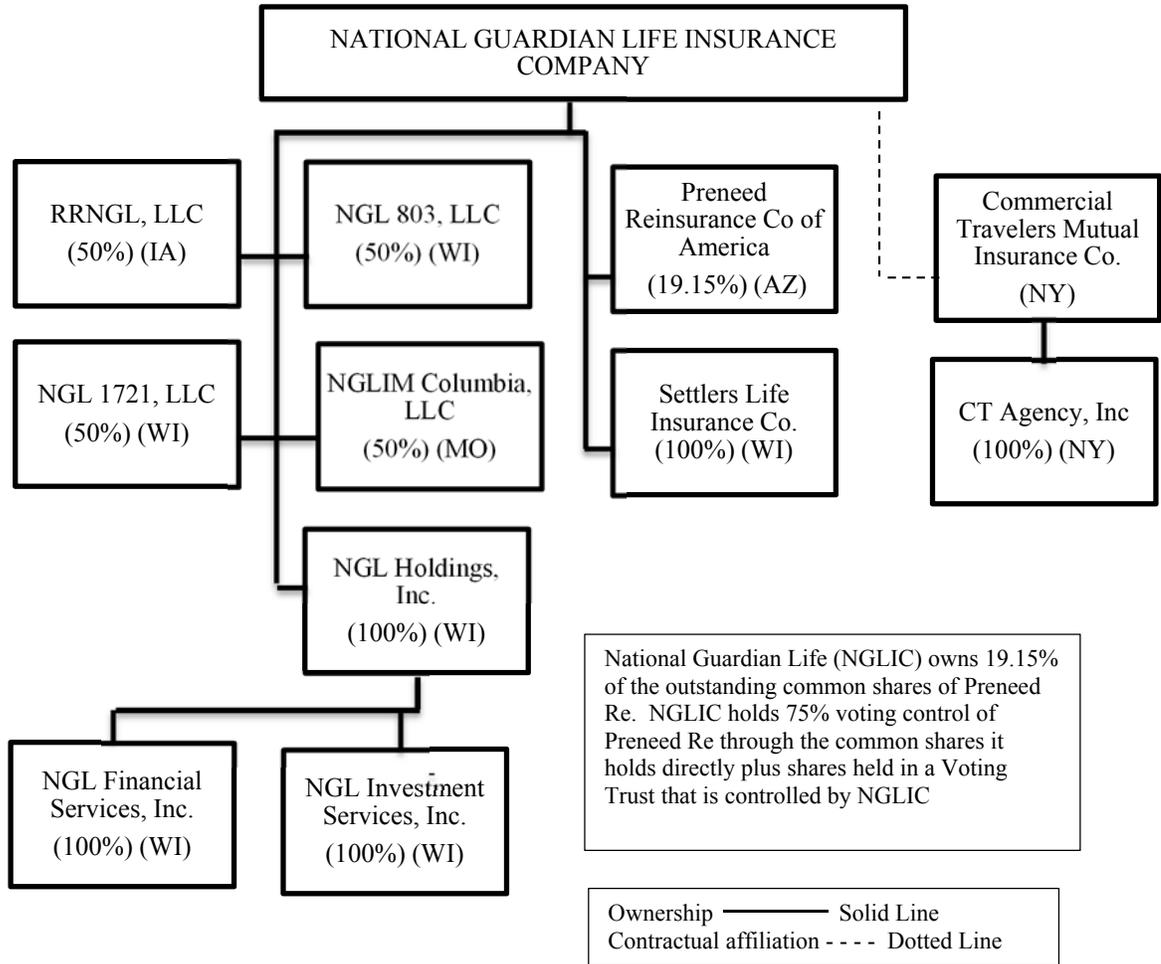
The following is a schedule of the Company's direct premiums written in New York compared to premiums written nationwide during the examination period:

	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>9/30/2013</u>
New York	\$ 1,605,441	\$ 3,597,890	\$ 2,986,187	\$ 1,734,009
Nationwide	21,468,867	18,351,963	17,078,541	7,221,080
% of Premiums written in New York	7.5%	19.6%	17.5%	24.0%

The decrease in premiums written in New York during the examination period was primarily due to numerous groups non-renewing their policies. Some of these groups were discontinued intentionally, due to underwriting losses and as part of the Company's strategic plan.

C. Holding Company System

The following chart depicts the Company and its relationship to members of its Holding Company System as of September 30, 2013:



National Guardian Life Insurance Company

During April 2012, CTMIC entered into an affiliation agreement with National Guardian Life Insurance Company (“NGLIC”), a Wisconsin-domiciled mutual life insurance company. This matter is discussed further herein under item 3D, “Affiliation with NGLIC”.

CT Agency, Inc.

On January 30, 1991, the Department approved the Company’s organization and acquisition of CT Agency, Inc., an entity that serves as an agent to aid the Company in placing business for policyholders that the Company cannot accommodate under its own underwriting guidelines. CT Agency, Inc. also places risks for unrelated companies, offering lines of business that may be of interest to CTMIC policyholders, such as life insurance.

The Company entered into a service agreement with CT Agency, Inc. on March 13, 1991. Under the agreement, which has been approved by the Department, the Company pays CT Agency, Inc. a commission on premiums earned for business placed with the Company.

Tax Allocation Agreement

Effective February 23, 2000, the Company entered into a consolidated tax allocation agreement with CT Agency, Inc. This agreement was found to be consistent with the guidelines contained in Circular Letter No. 33 (1979), and was approved by the Department on May 12, 2000. Although CTMIC has entered into an affiliation agreement with NGLIC, it continues to file its own consolidated income tax returns, in accordance with the terms of such agreement.

D. Affiliation with NGLIC

On April 20, 2012, CTMIC entered into an affiliation agreement with NGLIC, a Wisconsin-domiciled mutual life insurer. Under the terms of the affiliation agreement, NGLIC representatives hold a majority of the positions on CTMIC's board of directors. As part of the affiliation, the following agreements were executed:

1. CTMIC received \$5,000,000 from NGLIC in the form of a Surplus Note agreement;
2. CTMIC and NGLIC entered into a cost-sharing agreement under which NGLIC and CTMIC provide select services to each other with consideration for such services based on actual cost and usage; and
3. Pursuant to a Reinsurance Agreement, CTMIC ceded to NGLIC 50% of its in-force and newly issued or renewed student accident and health insurance effective as of January 1, 2012. The initial liabilities transferred under the Reinsurance agreement totaled \$8,980,000.

Subsequent to the affiliation date, CTMIC and NGLIC entered into four additional agreements, as follows:

- a. CTMIC issued a Line of credit promissory note to NGLIC for up to \$5 million on August 20, 2012, with an interest rate based on the Prime Rate as of the beginning of each quarter plus 2.0%.
- b. A surplus support agreement, effective September 25, 2012, under which NGLIC commits to provide CTMIC such funds as may be needed to ensure CTIC can promptly pay all insurance claims arising under CTMIC policies when due. NGLIC's maximum commitment under this agreement is \$25 million.
- c. An Administrative Services Agreement, effective August 1, 2013, in which CTMIC performs certain administrative functions relating to NGLIC's own student accident and health and special risk policies issued for non-New York business.
- d. A Marketing agreement, effective August 1, 2013, in which CTMIC provides various insurance marketing services for NGLIC's own student accident and health and special risk policies issued for non-New York business.

The agreements were non-disapproved by the New York State Department of Financial Services and the Wisconsin Office of the Commissioner of Insurance. CTMIC and NGLIC agreed that NGLIC will exercise "control" over CTMIC, as that term is defined by Section 1501(a)(2) of

the New York Insurance Law. In addition, CTMIC and NGLIC agreed, pursuant to commitments signed on behalf of both companies, that any direct or indirect transaction involving the companies, or any member(s) of NGLIC's holding company system, shall be governed by Section 1505 of the New York Insurance Law.

E. Reinsurance

CTMIC has several quota-share reinsurance agreements in effect with accredited reinsurers in order to protect itself against excessive exposure. The examiner reviewed all of the ceded agreements that were effective during the examination period. All agreements contained the required language, including an insolvency clause, meeting the requirements of Section 1308(a)(2)(A)(i) of the New York Insurance Law.

On April 23, 2012, the Company entered into a reinsurance agreement in which NGLIC assumed 50% of the risks, liabilities, rights and obligations with respect to the insurance policies, and any other liabilities (including without limitation, extra-contractual liabilities, commissions, claim containment expenses, and any associated excess reinsurance premiums) of CTMIC's in-force student accident and health business as of January 1, 2012, and 50% of CTMIC's new student accident and health business written after January 1, 2012.

On July 1, 2008, CTMIC entered into a 90% quota share reinsurance agreement with Union Security Life Insurance Company of New York, ("Union") for group long term disability policies underwritten and issued for and on behalf of Union with Disability Reinsurance Management Services, Inc., ("DRMS") as manager. CTMIC has appointed DRMS as its intermediary under an Administrative Services Agreement between the two parties for the purposes of performing

underwriting, claims, actuarial, compliance and administrative services on the business that is subject to the aforementioned agreement.

On April 1, 2011, CTMIC entered into a 100% quota share reinsurance agreement with Companion Life Insurance Company, (“Companion”) for non-New York student accident and health policies underwritten and issued for and on behalf of Companion with CTMIC as manager. Companion has appointed CTMIC as its agent under an Administrative Services Agreement between the two parties for the purposes of producing, underwriting, and managing the business that is subject to the aforementioned agreement.

On April 1, 2011, CTMIC entered into a 90% quota share reinsurance agreement with Niagara Life Insurance Company (“Niagara”) for New York student accident and health policies underwritten and issued for and on behalf of Niagara with CTMIC as manager. Niagara appointed CTMIC as its agent for the purpose of producing, underwriting, and managing the business that is subject to the aforementioned agreement.

As of September 30, 2013, the insurers included in these reinsurance agreements and their proportions of participation were as follows:

<u>Reinsurer</u>	<u>Effective Date</u>	<u>Type of Business</u>	<u>Description</u>
<u>Ceded</u> National Guardian Life Insurance Company	1/01/2012	School accident and health	Affiliate. 50% of all in force and newly issued school plans.
Union Security Life Insurance Co. of NY	7/01/2008	Group long term disability	90% ceded with Disability Reinsurance Management Services, Inc. (“DRMS”) as the intermediary.

<u>Reinsurer</u> <u>Assumed</u>	<u>Effective</u> <u>Date</u>	<u>Type of Business</u>	<u>Description</u>
Companion Life Insurance Company	4/1/2011	K-12/college	Non-NY business written on Companion paper, 100% assumed by CTMIC.
Niagara Life Insurance Company	4/1/2011	K-12/college	Niagara writes NY only K-12 and college business under its own license. 90% of this is assumed by CTMIC.

F. Third Party Administrators

During the examination period, the Company maintained five administrative service agreements with third party administrators (“TPAs”), under which the TPAs perform various claims administration, underwriting, actuarial, and compliance services in accordance with the terms of such agreements. These TPAs were as follows:

1. Morgan-White Administrators Inc.

CTMIC has an administrative services agreement with Morgan-White Administrators, Inc. (“Morgan-White”), under which Morgan-White performs underwriting, premium billing and collection, commissions, policy issuance, and policy servicing functions on behalf of CTMIC for its disability insurance business.

2. Consolidated Health Plans

CTMIC has an administrative services agreement with Consolidated Health Plans (“CHP”) to perform claim administration services for CTMIC. These services include evaluating, adjusting and, paying claims in accordance with school insurance policies issued by CTMIC. The agreement requires CHP to obtain written approval from an

authorized CTMIC employee prior to paying claims for an insured's diagnosis that exceed or are anticipated to exceed \$6,500 during the policy year.

CTMIC also contracted with CHP to collect premiums due on school insurance and special risks accident insurance policies. CHP remits premiums collected for the policies, less commissions, to CTMIC.

3. Disability Reinsurance Management Services, Inc.

CTMIC has an administrative services agreement with Disability Reinsurance Management Services, Inc. ("DRMS") to investigate, evaluate and adjudicate long term disability claims, and perform underwriting, actuarial, and compliance services in accordance with the terms of such agreement. DRMS also acts as an intermediary manager for Union Security Life Company of New York ("Union") in the quota share reinsurance agreement between CTMIC and Union, under which CTMIC cedes to Union 90% of the liabilities for group long term disability insurance policies.

4. NAHGA Claim Services and NAHGA, Inc.

CTMIC has an administrative services agreement with NAHGA Claim Services ("NCS") under which NCS performs claim administration services for CTMIC. These services include evaluating, adjusting and, when appropriate, paying claims in accordance with school insurance and special risk accident insurance policies issued by CTMIC on behalf of itself and Security Mutual Life Insurance Company of New York. The agreement requires NCS to obtain written approval from an authorized CTMIC employee prior to

paying claims for an insured that exceed or are anticipated to exceed \$5,000 during the policy year.

CTMIC also contracted with NAHGA, Inc. (“NAHGA”) in January 2006 for NAHGA to handle premium billings and collect premiums due on the school insurance and special risk accident insurance policies. NAHGA remits to CTMIC gross premiums collected for these policies less commissions.

5. Summit America Insurance Services, Inc.

CTMIC has a claims administration agreement with Summit America Insurance Services, Inc. (“Summit”) to perform claims administration services. These services include evaluating, adjusting and, when appropriate, paying claims in accordance with the terms of school insurance policies. The agreement requires Summit to obtain written approval from an authorized CTMIC employee whenever aggregate claim payments for any one insured on all claims incurred during one policy year exceeds or are anticipated to exceed \$10,000.

G. Significant Operating Ratios

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

	<u>Amounts</u>	<u>Ratios</u>
Claims incurred	\$ 49,861,286	61.5%
Commissions on premium	13,802,616	17.0%
General administrative expenses	30,940,632	38.2%
Net underwriting gain	(13,515,294)	(16.7%)
Premiums written	\$ <u>81,089,240</u>	<u>100%</u>

H. Custodial Agreements

Section 1, III – General Examination Considerations, F. Outsourcing of Critical Functions, Custodial or Safekeeping Agreements of the NAIC’s Financial Condition Examiners Handbook (the “Handbook”) states in part:

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

(j) 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.”

Section 83.2(a) of Insurance Regulation No. 172 (11 NYCRR 83) states in part:

“(a) Certain provisions of the Insurance Law provide that authorized insurers...shall file financial statements annually and quarterly with the superintendent. These entities are subject to the provisions of Sections 307 and 308 of the Insurance Law and are required to file what are known as Annual and Quarterly Statement Blanks on forms prescribed by the superintendent (“Financial Statements”)...the superintendent has prescribed forms and Annual and Quarterly Statement Instructions (“Instructions”) that are adopted from time to time by the *National Association of Insurance Commissioners* (“NAIC”), as supplemented by additional New York forms and instructions.”

A review of CTMIC’s custodial agreements indicated that such agreements failed to include the above-mentioned required clauses, as detailed in the Handbook and as adopted by Insurance Regulation No. 172 (11 NYCRR 83).

In addition, the Company answered “yes” to Question 28 of the General Interrogatories in all of its filed Annual Statements for the period under examination. This question relates to whether all stocks, bonds and other securities, owned throughout the examination period were held pursuant to a custodial agreement with a qualified bank or trust company in accordance with *Section 1, III – General Examination Considerations, F. Outsourcing of Critical Functions, Custodial or Safekeeping Agreements of the Handbook*.

While the New York Insurance Law does not require a domestic insurer to hold its investments in a custodial agreement with a bank, any custodial agreement between a bank and an insurer must set forth safeguards and provisions that must be assessed according to the guidelines followed by the Department as set forth in the Handbook, and adopted in Insurance Regulation No. 172 (11 NYCRR 83).

It is recommended the Company comply with Insurance Regulation No. 172 (11 NYCRR 83) by including the required clauses in its custodial agreements as contained in the NAIC's Handbook.

I. Information Technology

The Information Technology review of the Company was conducted to help identify risks related to the Company. The objective of the IT review was to determine whether Information Systems resources are properly aligned with the Company's objectives to ensure that significant risks (strategic, operational, reporting and compliance) arising from the IT environment are appropriately mitigated by strategies or IT general controls. In order to accomplish this objective, the examiner reviewed the general controls regarding the Company's processing environment and reviewed certain controls over the applications that were determined to be financially significant.

The IT review was performed in accordance with the Handbook. The framework for the scope of the IT review was as follows:

1. Gather necessary IT information;
2. Review information gathered;
3. Request control information and complete IT review planning;
4. Conduct IT review fieldwork;

5. Document results of IT review; and
6. Assist with the financial examination.

The examiner identified a number of deficiencies in the Company's IT control environment where the documentation to support adequate controls was not maintained in a manner that would show that such controls were implemented and are operating effectively. In addition, the examiner identified a number of IT general controls for which the documentation provided in the Company's response to the Department's IT questionnaire did not sufficiently describe the effective implementation of such controls to mitigate the associated risks.

The examination review also revealed that the Company failed to consistently utilize IT general controls in the application of its IT controls environment. This failure may have resulted in the "non-functioning" of several IT general controls. As a result, certain strategic, operational, reporting and compliance risks associated with these controls may not have been fully mitigated.

J. Enterprise Risk Management ("ERM")

Circular Letter No. 14 (2011) establishes the following as components of an effective Enterprise Risk Management program. Included are the following:

- A written risk policy that delineates the insurer's risk/reward framework, risk tolerance levels, and risk limits. An insurer's ERM function should provide for the identification and quantification of risk under a sufficiently wide range of outcomes using techniques that are appropriate to the nature, scale, and complexity of the risks the insurer bears and are adequate for capital management and solvency purposes.
- A process of risk identification and quantification supported by documentation providing appropriately detailed descriptions and explanations of risks identified, the measurement approaches used, key assumptions made, and outcomes of any plausible adverse scenarios that were run. Prospective solvency assessments, including scenario and stress testing, should be a key component of the ERM function, as they can help highlight the impact of such scenarios and stresses on an insurer's future solvency. The insurer's ERM function should incorporate

risk tolerance levels and limits in the policies and procedures, business strategy, and day-to-day strategic decision-making processes.

- In the context of its overall ERM framework, an insurer should consider a risk and capital management process to monitor the level of its financial resources relative to its economic capital and the regulatory capital requirements. Additionally, an effective ERM function should incorporate investment policy, asset-liability management policy, effective controls on internal models, longer-term continuity analysis, and feedback loops to update and improve ERM continuously.
- An insurer should address as part of its ERM all reasonably foreseeable and relevant material risks including, as applicable: insurance; underwriting; asset-liability matching; credit; market; operational; reputational; liquidity; and any other significant risks associated with group membership. The assessment should include identifying the relationship between risk management and the level and quality of financial resources necessary as determined with quantitative and qualitative metrics.

NGLIC relies on its risk management process to monitor the business and financial risk exposures of the NGLIC Insurance Group, of which CTMIC is an affiliate. NGLIC's Risk Management Committee meets when necessary to discuss and review risk issues. The committee communicates risk management policies, key monitoring metrics, and internal control processes to the board of directors, responsible officers of NGLIC and its business entities.

The risk management process is designed to identify material risks facing NGLIC, as well as to prioritize those risks in the context of CTMIC's overall strategy. ERM is performed at the NGLIC holding company level and applied to its subsidiaries and affiliates, including CTMIC. NGLIC's Risk Management team is led by its Director of Corporate Risk Management, who is also the Chief Internal Auditor and Director of Business Continuity and Planning.

The Company provided the examiner with a list of its eighteen "top risk rankings," as of April 2012 and February 2014, respectively. A review of this list showed that fourteen of the eighteen top risks had a residual risk score of medium or higher as of April 2012. The review also showed that eleven of eighteen of these same risks had a residual risk score of medium or higher, as of February 2014. However, the Company did not provide supporting documentation or

detailed descriptions and explanations of the “top risks” it identified, the measurement approaches used, key assumptions made, and outcomes of any plausible adverse scenarios that were run, as required by the aforementioned Circular Letter.

The examiner observed that the Company’s comments relating to the “top risks” were general in nature and did not quantify such risks in a manner that was appropriate to the nature, scale, and complexity of the risks, or adequacy for capital management and solvency purposes. It should be noted that prospective solvency assessments, including scenario and stress testing, should be a key component of the ERM function, as they can help highlight the impact of such scenarios and stresses on an insurer’s future solvency. The insurer’s ERM function should incorporate risk tolerance levels and limits in the policies and procedures, business strategy, and day-to-day strategic decision-making processes.

The examiner was informed that NGLIC’s formal approach to risk management is predominantly on an enterprise-wide or group basis, and viewed CTMIC as a small part of the overall group, thus influencing the risk management efforts related to CTMIC.

It is recommended that the Company modify its risk policy to delineate the risk/reward framework, risk tolerance levels, and risk limits. It is also recommended that the Company identify and quantify its risks in a manner that is appropriate to the nature, scale, and complexity of the risks the insurer bears and that such identification and quantification are adequate for capital management and solvency purposes.

It is recommended that the Company maintain supporting documentation with appropriate, detailed descriptions and explanations of the risks identified, the measurement approaches used, key assumptions made, and outcomes of any plausible adverse scenarios that were run.

It is recommended that prospective solvency assessments, including scenario and stress testing, be made a key component of the Company's ERM function, highlighting the impact of such scenarios and stresses on the Company's future solvency.

It is recommended that the ERM function incorporate risk tolerance levels and limits in the policies and procedures, business strategy, and day-to-day strategic decision-making processes.

It is recommended that the Company consider a risk and capital management process to monitor the level of its financial resources relative to its economic capital and regulatory capital requirements.

It is recommended that the ERM function incorporate investment policy, asset-liability management policy, effective controls on internal models, longer-term continuity analysis, and feedback loops to update and improve ERM continuously.

K. Fraud Prevention Plan

Section 409(a) of the New York Insurance Law states:

“(a) Every insurer writing...individual, group or blanket accident and health insurance policies issued or issued for delivery in this state, except for insurers that write less than three thousand of such policies, issued or issued for delivery in this state annually...shall, within one hundred twenty days of the effective date of this amended section to be promulgated by the superintendent to implement this section, file with the superintendent a plan for the detection, investigation and prevention of fraudulent insurance activities in this state and

those fraudulent insurance activities affecting policies issued or issued for delivery in this state...”

During the examination period, CTMIC failed to file a fraud prevention plan in accordance with the provisions of Section 409(a) of the New York Insurance Law. The examiner determined, based upon the number of policies issued, that CTMIC should have filed a fraud prevention plan with the Department.

It is recommended that CTMIC comply with the provisions of Section 409(a) of the New York Insurance Law by filing the required fraud prevention plan.

L. Location of Books and Records

During the examination review of CTMIC’s operations, it was noted that certain books of account were removed from its principal office in New York State during the period beginning July 2012 through November 2013, without the Superintendent’s prior approval.

Section 325(b) of the New York Insurance Law states in part:

“A domestic insurer...may keep and maintain its books of account without this state if, in accordance with a plan adopted by its board of directors and approved by the superintendent, it maintains in this state suitable records in lieu thereof...”

The Department informed CTMIC that the movement of books and records outside of New York without the Superintendent’s approval violated Section 325(b) of the New York Insurance Law.

It is recommended that CTMIC’s board of directors comply with the provisions of Section 325 of the New York Insurance Law by adopting a plan to maintain suitable records at its principal office in New York and to submit such plan to the Superintendent for approval.

Such resolution was submitted to the Department on August 28, 2013, revised on November 18, 2013, and approved by the Department on December 2, 2013.

M. Subsequent Event - Reorganization of CTMIC to a Domestic Stock Insurance Company

Section 7313(b) of the New York Insurance Law states in part:

“(1) A domestic mutual insurer may apply to the superintendent for permission to reorganize and convert into a domestic stock accident and health insurer complying with the relevant organization and licensing provisions of articles twelve and forty-two of this chapter. The application to the superintendent shall be pursuant to a resolution, adopted by no less than a majority of the entire board of directors, specifying the reasons for and the purposes of the proposed conversion and the manner in which the conversion is expected to benefit policyholders and the public. A copy of the resolution, together with a statement of its adoption, both certified by the president and secretary, or officers corresponding to either of them, and affirmed by them as true under the penalties of perjury and under the seal of the mutual insurer, and such other information as the superintendent may require shall accompany the application.

(2) The superintendent shall order an examination of the mutual insurer pursuant to section three hundred ten of this chapter as of the last day of the period covered in the insurer's latest filed statement...”

In addition, Section 7313(f) of the New York Insurance Law states:

“(f) The mutual insurer shall give prompt notice to all persons who become policyholders or holders of agreements subject to section one thousand three hundred seven of this chapter on or after the date of the adoption of the resolution described in subsection (b) of this section. The notice shall specify the pendency of a proposed conversion and the effect the conversion shall have on them.”

On October 21, 2013, CTMIC submitted an application under New York Insurance Law Section 7313(b)(1) seeking permission to reorganize and convert into a domestic stock accident and health insurance company. Such application included a copy of the resolutions that were adopted unanimously by the board of directors on October 3, 2013. The resolutions specify the reasons for and the purposes of the proposed conversion and the manner in which the conversion is expected to benefit policyholders and the public.

Among the stated reasons for and the purposes of the proposed conversion were:

1. Increase access to capital and specifically permit the infusion of additional capital by NGLIC other than through surplus notes.
2. Improve its A.M. Best Rating as a result of the closer ties to NGLIC and increased capitalization planned, with the Company eventually sharing NGLIC's group rating of "A-". This will allow CTMIC to compete for corporate or governmental accounts, or expand into additional product offerings that commonly require an A.M. Best rating of "A-" or higher.
3. Create a financially stronger company better able to meet its obligations to policyholders by increasing the Company's ability to endure and respond to adverse experience.
4. Create a financially stronger company better able to compete in the marketplace by creating more competitive economies of scale resulting from sales growth, the result of the improved AM Best rating, the market's response to the Company's increased capitalization, and the increased capacity provided by the increase in capital.

On November 25, 2013, the Department found the application filed with the Superintendent to be acceptable in accordance with Section 7313(b) of the New York Insurance Law and ordered an examination of CTMIC as of September 30, 2013. Further, pursuant to Section 7313(f) of the New York Insurance Law, prompt notice should be given to all persons who became policyholders or holders of Section 1307 agreements on or after October 3, 2013, of the pendency of the proposed conversion and the effect thereof on them.

This examination was also conducted in accordance with the provisions of Section 7313(b)(2) of the New York Insurance Law.

3. FINANCIAL STATEMENTS

The following statements show the assets, liabilities, and surplus as of September 30, 2013, as contained in the Company's filed quarterly statement, a condensed summary of operations and a reconciliation of the surplus account for each of the years under review. The examiner's review of a sample of transactions did not reveal any differences which materially affected the Company's financial condition as presented in its financial statements contained in the September 30, 2013 filed quarterly statement.

Independent Accountants

The firm of Ernst & Young, LLP was retained by the Company during 2012 to audit the Company's combined statutory basis statements of financial position and the related statutory-basis statements of operations, surplus, and cash flows for the year then ended.

After making certain adjustments, Ernst & Young, LLP concluded that the statutory financial statements presented fairly, in all material respects, the financial position of the Company at the respective audit dates. Balances reported in these audited financial statements were reconciled to the corresponding statements with no discrepancies noted.

A. Balance SheetAssets

Bonds	\$ 12,515,547
Common stock	260,824
Real estate - properties occupied by the Company	176,893
Cash, cash equivalents, and short-term investments	5,541,756
Investment income due and accrued	46,928
Uncollected premiums and agents' balances in the course of collection	3,049,052
Amounts recoverable from reinsurers	55,394
Amounts receivable relating to uninsured plans	2,218
EDP equipment and software	6,501
Guaranty funds receivable or on deposit	3,117
Miscellaneous Receivable	<u>6,489</u>
Total assets	\$ <u>21,664,719</u>

Liabilities

Aggregate reserve for accident and health contracts	\$ 5,392,876
Accident and health contract claims	2,291,203
Premiums and annuity considerations for life and accident and health contracts received in advance	47,510
Other amounts payable on reinsurance ceded	154,682
Commissions to agents due or accrued-accident and health	145,326
General expenses due or accrued	349,993
Taxes, licenses and fees due or accrued, excluding federal income taxes	97,371
Current federal and foreign income taxes	1,316
Amounts withheld or retained by company as agent or trustee	11,763
Amounts held for agents' account	28
Remittances and items not allocated	23,239
Asset valuation reserve	61,982
Funds held under reinsurance treaties with unauthorized and certified reinsurers	3,063,774
Payable to parent, subsidiaries and affiliates	2,277,902
Liability for pension benefits	4,084,029
Unclaimed funds	<u>49,732</u>
Total liabilities	\$ <u>18,052,726</u>

Surplus

Surplus notes	5,000,000
Unassigned funds	\$ <u>(1,388,007)</u>
Surplus	\$ <u>3,611,993</u>
Total liabilities and surplus	\$ <u>21,664,719</u>

Note: The Internal Revenue Service has not conducted any audits of the income tax returns filed on behalf of the Company through tax year 2014. 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. Statement of Revenue and Expenses and Surplus

Surplus decreased \$4,017,774 during the period January 1, 2010 through September 30, 2013, as follows:

Revenue

Premiums	\$ 81,089,240	
Net investment income	498,461	
Amortization of IMR	(2,193)	
Commissions and expense allowances on reinsurance ceded	3,335,987	
Administrations fees	2,471,190	
Receivable from Standard Security	110,000	
Miscellaneous income	<u>29,841</u>	
Total revenue		\$ 87,532,526

Expenses

Disability benefits and benefits under accident and health contracts	\$ 58,973,604	
Interest and adjustments on contract or deposit-type contract funds	248	
Increase in reserves for life and accident and health contracts	(9,112,566)	
Commissions on premiums	7,932,941	
Commissions and expense allowances on reinsurance assumed	5,869,675	
General insurance expenses	27,435,000	
Insurance taxes, licenses and fees, excluding federal income taxes	3,412,397	
Interest expense on funds withheld	44,646	
Regulatory fees and penalties	4,442	
Miscellaneous losses	<u>44,147</u>	
Total underwriting expenses		\$ <u>94,604,534</u>
Net loss from operations before federal income taxes		\$ (7,072,008)
Less: Federal and foreign income taxes		<u>(494)</u>
Net loss from operations after federal income tax		\$ (7,071,514)
Net realized capital gains		<u>1,442,712</u>
Net loss		\$ <u>(5,628,802)</u>

Change in Surplus

Surplus, per report on examination, as of December 31, 2009			\$ 7,629,767
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net loss		\$5,628,802	
Change in net unrealized capital gains		1,690,897	
Change in net deferred income tax		1,406,272	
Change in non-admitted assets	2,239,115		
Change in asset valuation reserve		61,982	
Change in liability for pension benefits		4,084,027	
Change in surplus notes	5,000,000		
Prior report on examination premium deficiency reserve	1,150,000		
Prior period adjustment due to correction of error	465,091		
	<hr/>	<hr/>	
Net decrease in surplus			<u>(4,017,774)</u>
Surplus, per report on examination, as of September 30, 2013			\$ <u>3,611,993</u>

4. UNPAID CLAIMS

Aggregate Reserve for Accident and Health Contracts

The examination liability of \$5,392,876 for the above captioned account is the same as the amount reported by the Company in its filed quarterly statement as of September 30, 2013.

The examination analysis of the claims unpaid reserve 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 as verified by the examiner.

The examination reserve was based upon actual payments made through a point in time, plus an estimate for claims remaining unpaid at that date. Such estimate was calculated based on actuarial principles, which utilized the Company's experience in projecting the ultimate cost of claims incurred on or prior to September 30, 2013.

5. SUMMARY OF PRIOR COMMENTS AND RECOMMENDATIONS

The prior report on examination, as of December 31, 2009, contained the following twelve (12) financial related recommendations (page numbers refer to the prior report on examination). Additional recommendations related to the Market Conduct portion of that report may be found in a separately filed Market Conduct report on examination.

ITEM NO.

PAGE NO.

Management and Controls

- | | | |
|----|---|---|
| 1. | It is recommended that the Company's senior officers and the board consider the creation of an Enterprise Risk Management ("ERM") program that would formally identify risks and establish controls to mitigate such risks. | 7 |
|----|---|---|

The Company has complied with this recommendation.

- | | | |
|----|---|---|
| 2. | It is recommended that the Company establish and maintain procedures which require all board members, officers and key employees to sign a Conflict of Interest Statement on an annual basis or whenever the circumstances dictate that it would be appropriate to do so. | 8 |
|----|---|---|

The Company has complied with this recommendation.

Holding Company System

- | | | |
|----|--|----|
| 3. | It is recommended that the Company comply with the requirements of Section 1505(a) of the New York Insurance Law and charge an equitable rate for the rental of space within its facilities. | 12 |
|----|--|----|

It is noted that the Company rectified this deficiency while the examination was being conducted.

The Company has complied with this recommendation.

ITEM NO.**PAGE NO.**Reinsurance

4. It is recommended that the Company institute controls over its reinsurance program to include the following: 14
- The Company should formalize its reinsurance strategy;
 - The board of directors and affected departments within the Company should be consulted and/or participate in the establishment of the reinsurance program, the reinsurance contracts and the reinsurance limits;
 - Management should apprise the board of directors, at least annually, of the reinsurance program's status;
 - The Company should obtain a SAS 70 report or other control documents from its reinsurers at least annually;
- and

The Company should formalize policies and procedures in order to ensure claims are handled in a timely and efficient manner.

The Company has complied with this recommendation.

Third Party Administrators

5. It is recommended that the Company ensure that the Disaster Recovery plans of its TPAs are valid, operational and current, with specific instructions for implementation. 16

The Company has complied with this recommendation.

Accounts and Records

6. It is recommended that the Company comply with the requirements of Section 1314(g)(1) of the New York Insurance Law and include in its Custodial Agreement for the New York State Escrow Deposit all clauses required by that Law. 17

Subsequent to the examination, the Company had this Custodial Agreement amended to include such requirement.

The Company has complied with this recommendation.

ITEM NO.**PAGE NO.**

7. It is recommended that the Company ensure that its agents are properly billing for their School Groups. Additionally, it is recommended that, where an agent is maintaining a large unpaid premium balance at year end, the Company take steps to definitively establish the cause for the late premium balances and initiate collection. 18

The Company has complied with this recommendation.

8. It is recommended that the Company place grace cancellation periods within its College group contracts. 18

The Company has complied with this recommendation.

Special Risk Coverage

9. It is recommended that the Company take steps to mitigate the risks associated with its failure to obtain the policy listing of insureds under its Special Risk coverage contracts. 19

The Company has complied with this recommendation.

ITEM NO.**PAGE NO.**Information Technology

10. It is recommended that the Company improve upon existing controls of its IT Department by developing and incorporating the following controls within its IT Control procedures: 21
- A formally documented IT Strategic Plan which is presented to the board of directors and audit committee on a periodic basis.
 - A policy that requires that purchasing of all computer and electronic equipment go through the IT DPR approval process.
 - Institute periodic testing of transactions entered into by the programming staff on live applications.
 - Improve upon the security and storing process of sensitive claim files, which may be accomplished through the use of an electronic image backup system, which reduces the exposure and vulnerability of claim files to fire, theft and unauthorized use.
 - Installation of a fire suppression system for its computer room.

The Company has complied with this recommendation.

11. It is recommended that the Company ensure that its IT Department is apprised of all internal and external audit issues pertaining to IT issues and that such apprisement of internal and external audit issues take place in an expeditious manner. 22

The Company has complied with this recommendation.

Accident and Health Claims – Premium Deficiency Reserve

12. It is recommended that the Company comply with the provisions of Paragraph 18 of SSAP No. 54 of the NAIC Accounting Practices and Procedures Manual by establishing an appropriate liability for its premium deficiency reserve. 28

The Company has complied with this recommendation.

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Corporate Governance</u>	
i. It is recommended that the Company comply with the provisions of Sections 1206(a) and (6) and 1209(d) of the New York Insurance Law by obtaining the Superintendent's approval prior to implementing changes to its charter and/or by-laws and subsequently file such changes with the County Clerk.	8
Subsequent to the examination date, on January 28, 2014, the Company submitted the amendments to its charter and by-laws to the Department for approval. Such amendments to the charter and by-laws were approved by the Superintendent on March 25, 2014, and placed on file with the County Clerk's office on April 14, 2014.	
ii. It is recommended that the Company and its board comply with the provisions of Section 1411(a) of the New York Insurance Law by authorizing and approving investments on at least a quarterly basis, and by recording such approvals in the minutes of the board of directors.	9
B. <u>Custodial Agreements</u>	
It is recommended the Company comply with Insurance Regulation No. 172 (11 NYCRR 83) by including the required clauses in its custodial agreements as contained in the NAIC's Handbook.	21
C. <u>Enterprise Risk Management</u>	
i. It is recommended that the Company modify its risk policy to delineate the risk/reward framework, risk tolerance levels, and risk limits. It is also recommended that the Company identify and quantify its risks in a manner that is appropriate to the nature, scale, and complexity of the risks the insurer bears and that such identification and quantification are adequate for capital management and solvency purposes.	24

<u>ITEM</u>	<u>PAGE NO.</u>
ii. It is recommended that the Company maintain supporting documentation with appropriate, detailed descriptions and explanations of the risks identified, the measurement approaches used, key assumptions made, and outcomes of any plausible adverse scenarios that were run.	24
iii. It is recommended that prospective solvency assessments, including scenario and stress testing, be made a key component of the Company's ERM function, highlighting the impact of such scenarios and stresses on the Company's future solvency.	25
iv. It is recommended that the ERM function incorporate risk tolerance levels and limits in the policies and procedures, business strategy, and day-to-day strategic decision-making processes.	25
v. It is recommended that the Company consider a risk and capital management process to monitor the level of its financial resources relative to its economic capital and regulatory capital requirements.	25
vi. It is recommended that the ERM function incorporate investment policy, asset-liability management policy, effective controls on internal models, longer-term continuity analysis, and feedback loops to update and improve ERM continuously.	25
D. <u>Fraud Prevention Plan</u>	
It is recommended that CTMIC comply with the provisions of Section 409(a) of the New York Insurance Law by filing the required fraud prevention plan.	26
E. <u>Location of Books and Records</u>	
It is recommended that CTMIC's board of directors comply with the provisions of Section 325 of the New York Insurance Law by adopting a plan to maintain suitable records at its principal office in New York and to submit such plan to the Superintendent for approval.	26
Such resolution was submitted to the Department on August 28, 2013, revised on November 18, 2013, and approved by the Department on December 2, 2013.	

APPOINTMENT NO. 30950

NEW YORK STATE
DEPARTMENT OF FINANCIAL SERVICES

I, **BENJAMIN M. LAWSKY**, Superintendent of Financial Services of the State of New York, pursuant to the provisions of the Financial Services Law and the Insurance Law, do hereby appoint:

Pearson Griffith

as a proper person to examine the affairs of the

Commercial Travelers Mutual Insurance Company

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

Company

with such other information as he shall deem requisite.

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

this 6th day of March, 2013

BENJAMIN M. LAWSKY
Superintendent of Financial Services

By:



Stephen J. Wiest
Deputy Bureau Chief
Health Bureau

