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

George E. Pataki
Governor

Gregory V. Serio
Superintendent

REPORT ON EXAMINATION

OF THE

ALLEGANY CO-OP INSURANCE COMPANY

AS OF

DECEMBER 31, 2001

DATE OF REPORT: NOVEMBER 25, 2002

EXAMINER: GERARD L FRANCO

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

George E. Pataki
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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 the instructions contained in Appointment No. 21905, dated June 11, 2002, attached hereto, I have made an examination into the condition and affairs of the Allegany Co-op Insurance Company as of December 31, 2001 and submit the following report thereon.

The examination was conducted at the Company's home office located at 9 North Branch Road, Cuba, New York 14727.

Whenever the designations "the Company" or "ACIC" appear herein without qualification, they should be understood to indicate the Allegany Co-op Insurance Company.

1. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 1997. This examination covered the four year period from January 1, 1998 through December 31, 2001, and was limited in its scope to a review or audit of only those balance sheet items considered by this Department to require analysis, verification or description, including; invested assets, inter-company balances, loss and loss adjustment expense reserves and the provision for reinsurance. 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. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

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 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

The Company was organized on April 3, 1887 as the Allegany County Farmers' Co-operative Fire Insurance Company for the purpose of transacting business as an assessment co-operative fire insurance company in Allegany County, New York. A certificate, issued by this Department on July 19, 1971, permitted the Company to change its name to the Allegany Co-op Insurance Company.

On April 11, 1980, a merger was effected with the Farmers' Co-operative Fire Insurance Company of Steuben County, New York, domiciled at Hornell, New York. Allegany Co-op Insurance Company was the surviving corporation.

On January 1, 1990, a merger was effected with the German Mutual Insurance Company, of Wayland, New York. Allegany Co-op Insurance Company was the surviving corporation.

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 fifteen members. As of the examination date, the board of directors was comprised of twelve members, divided into three groups, as nearly equal as possible, with one group being elected at each annual policyholders' meeting for a term of three years.

Every person insured by the Company is entitled to one vote in person or by proxy at each of its annual meetings. The annual meeting of the board of directors is held immediately after the annual meeting of the Company. At least four board meetings were held each year for the period under examination, thereby complying with Section 6624(b) of the New York Insurance Law.

The directors as of December 31, 2001, were as follows:

Director	Principal Business Affiliation
Rae A. Clark, Jr. Pittsford, NY	Attorney, Sutton, DeLeeuw, Clark & Darcy
Delores S. Cross Cuba, NY	Retired
Marcia J. Davies Freedom, NY	Board member, Monroe Co-operative Fire Insurance Company
Bruce Donnan Piffard, NY	Farmer
Clifford Feldman West Valley, NY	Excavating contractor
Wilson L. Gilbert Rushford, NY	Chairman of the board of ACIC
Kevin D. Harris Wellsville, NY	President, CEO Harris Supply Company, Inc.
Erland E. Kailbourne Williamsville, NY	Chairman, John R. Oishei Foundation
Donald C. Kear Whitesville, NY	Retired
Clifton E. Rounds, Jr Addison, NY	Vice President of ACIC; Farmer
J. Michael Shane Allegany, NY	Secretary of ACIC; Attorney
Duane A. Vaclavik Fillmore, NY	CEO of GVTA Federal Credit Union

The minutes of all meetings of the Board of Directors' and committees thereof held during the examination period were reviewed. The average attendance by the board of directors during the examination period was approximately 88% with each individual director's attendance being adequate at these meetings, with the exception of Erland E. Kailbourne, whose attendance for the last year and half of the examination period was 35%.

Members of the board have a fiduciary responsibility and must evince an ongoing interest in the affairs of the insurer. It is essential that board members attend meetings consistently and set forth their views on relevant matters so that appropriate policy decisions may be reached by the board. Board members who are unable or unwilling to attend meetings consistently should resign or be replaced. Therefore, it is recommended that Director Erland E. Kailbourne should either improve his attendance at board meetings or be replaced by the policyholders.

Each of the directors' qualifications, as set forth in Article IV Section 1 of the Company's by-laws, were reviewed, and each director is duly qualified, with the exception of director Rae A. Clark, Jr. Article IV Section 1 states, in part, that directors "... shall be members of the Company…" Mr. Clark was elected to the board in June of 1999 and as of the examination date did not hold a policy with the Company. Therefore, it is recommended that the Company comply with Article IV Section 1 of its by-laws by having all members of the board maintain a policy with the Company.

At December 31, 2001, the officers of the Company were as follows:

Chairman of the Board	Wilson L. Gilbert
President	James M. Russell
Secretary	J. Michael Shane
Treasurer	Duane A. Vaclavik
Vice President	Clifton E. Rounds, Jr.

B. Territory and Plan of Operation

The Company is authorized to transact business within all the counties of the State of New York, excluding the Counties of New York, Kings, Queens, Bronx and Richmond. The Company writes only in New York State.

Calendar Year	Direct Premiums Written
1998	$5,713,818
1999	5,813,916
2000	6,133,529
2001	6,608,877

As of December 31, 2001, the Company was authorized to transact the kinds of insurance defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

Paragraph	Kind of Insurance
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	Workers' compensation and employers' liability(excluding workers' compensation)
19	Motor vehicle and aircraft physical damage (excluding aircraft physical damage)
20	Marine and inland marine(inland marine only)

The Company was also licensed as of December 31, 2001, to accept and cede reinsurance as provided in Section 6606 of the New York Insurance Law.

Based upon the lines of business for which the Company is licensed, and pursuant to the requirements of Articles 13 and 66 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of $100,000.

At December 31, 2001, the Company wrote insurance through independent agents.

The Company's predominate lines of business are homeowners multiple peril and commercial multiple peril, which accounted for 40.0% and 38.1% respectively, of the Company's 2001 direct written business.

C. Reinsurance

The Company assumed no business during the examination period.

The Schedule F's as contained in the Company's Annual Statements filed for the years within the examination period were found to accurately reflect its reinsurance transactions.

The examiner reviewed all ceded reinsurance contracts effected during the examination period. These contracts all contained the required standard clauses including insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

As of December 31, 2001, the Company had the following property and casualty combination excess of loss reinsurance program in place:

Property 2 layers	$215,000 x/s of $85,000 ultimate net loss, any one risk; subject to further limit of $500,000 in any one occurrence $700,000 x/s $300,000 ultimate net loss any one risk
Casualty 2 layers	$915,000 x/s of $85,000 ultimate net loss any one occurrence
Casualty Clash	$2,000,000 x/s of $1,000,000 in any one occurrence
Property Catastrophe (4 layers)	95% of $1,200,000 x/s of $300,000 ultimate net loss each occurrence 100% x/s of $1,500,000 ultimate net loss each loss occurrence
Aggregate	95% of $1,000,000 of net losses exceeding 75% of net earned premiums in any one agreement year

As of December 31, 2001 the Company had the following property facultative reinsurance program in place with the Guilderland Reinsurance Company:

Property	facultative cessions which are the lesser of 50% of the entire risk or $500,000 in respect of any property risk reinsured

As of December 31, 2001 the Company had in effect the following property facultative reinsurance program with Monroe Co-operative Fire Insurance Company:

Property	facultative cessions which are the lesser of 50% of the entire risk or $500,000 in respect of any property risk reinsured

As of December 31, 2001 the Company also had in effect a property net line quota share reinsurance program with Monroe Co-operative Fire Insurance Company(MCFIC). Pursuant to the terms of this reinsurance contract, ACIC cedes 25% quota share of the net property business written and assumed to MCFIC. The cessions under this contract are limited to $21,250 (being 25% of a maximum of $85,000) each risk each individual loss, plus a proportionate share of loss expenses, subject to a maximum of $75,000 for each and every loss occurrence.

Since the date of the prior examination, December 31, 1997, the Company increased its net retention from $70,000 to $85,000 on property business and from $50,000 to $85,000 on casualty business.

D. Holding Company System

On June 30, 1999 a Section 1307 Surplus Note in the amount of $1,000,000 was issued by the Monroe Co-operative Fire Insurance Company to Allegany Co-op Insurance Company. A review of the Surplus Note showed compliance with all applicable sections of law.

Also, an Expense Sharing Agreement was entered into by ACIC and MCFIC that became effective July 1, 1999. After completing a review of the agreement it was determined that Allegany Co-op has been charging MCFIC expenses that related to the sharing agreement on the actual time and cost incurred based upon timesheets with individual’s salaries and related benefits when employees were on-site at the home office of MCFIC. Any expenses for ACIC employees working on MCFIC related business while at ACIC home office was not allocated to MCFIC. According to the agreement, starting January 1, 2001, all expenses shall be allocated pursuant to a time study based on the allocation of expense in the prior year. However, ACIC continued the aforementioned expense methodology which did not include an allocation for ACIC employees working on MCFIC related business while at the ACIC home office. Also, Regulation 30 (NYCRR Part 109.2) states that when a direct allocation of salaries is not used, time studies is one of the appropriate bases that can be used. Therefore, it is recommended that the Company comply with both Regulation 30 (NYCRR Part 109.2) and the terms of the Expense Sharing Agreement and develop a method of allocation that will more accurately reflect the employees' actual work expenses with respect to the Monroe Co-operative Fire Insurance Company.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2001, based upon the results of this examination:

Net premiums written in 2001 to Surplus as regards policyholders	.47 to 1
Liabilities to liquid assets(cash and invested assets less investments in affiliates)	44.6%
Premiums in course of collection to Surplus as regards policyholders	.49%

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

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

	Amounts	Ratios
Losses incurred	$ 8,684,770	43.97%
Loss adjustment expenses incurred	3,368,266	17.05%
Other underwriting expenses incurred	9,054,478	45.84%
Net underwriting gain(loss)	(1,355,169)	(6.86%)
Premiums earned	$19,752,345	100.00%

F. Abandoned Property

During the period covered by this examination, the Company filed reports with the state comptroller as required by Section 1316 of the New York Abandoned Property Law.

3. FINANCIAL STATEMENTS

A. Balance sheet

The following show the assets, liabilities and surplus as regards policyholders as determined by this examination as of December 31, 2001. This statement is the same as the balance sheet filed by the Company.

Assets	Ledger Assets	Not Admitted Assets	Net Admitted Assets
Bonds	$9,465,364	$ -0-	$9,465,364
Common stocks	4,125,650	-0-	4,125,650
Real Estate	1,202,575	-0-	1,202,575
Cash and short term investments	194,939	-0-	194,939
Other invested assets	1,000,000	-0-	1,000,000
Agents' balances or uncollected premiums	1,145,857	2,472	1,143,385
Reinsurance recoverable on loss and loss adjustment expenses	91,292	-0-	91,292
Federal and foreign income tax recoverable	110,000	-0-	110,000
Electronic data processing Equipment	38,339	-0-	38,339
Interest, dividends and real estate income due and accrued	207,302	-0-	207,302
Other assets nonadmitted	167,654	167,654	-0-
Aggregate write-ins for other than invested assets	258,624	217,349	41,275
Total	$18,007,596	$387,475	$17,620,121

Liabilities and Surplus

Losses and loss adjustment expenses		$1,720,990
Contingent commissions and other similar charges		429,720
Other expenses		127,092
Taxes, licenses and fees		5,507
Federal and foreign income taxes		630,021
Unearned premiums		3,433,641
Ceded reinsurance premiums payable		365,438
Aggregate write-ins for liabilities		120,754
Total liabilities		$6,833,163
Unassigned funds(surplus)	$ 100,000	
Special contingent surplus	10,686,958	
Surplus as regards policyholders		10,786,958
Total		$17,620,121

The Internal Revenue Service did not audit the Company's federal income tax returns during the period under examination. Audits covering subsequent tax years have yet to commence. Except for any impact that might result from the examination changes contained in this report, the examiner is unaware of any potential exposure of the Company to any further tax assessment and no liability has been establish herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders decreased by $83,849 during the four-year examination period, January 1, 1998 to December 31, 2001, detailed as follows:

Statement of Income

Underwriting Income		
Premiums		$19,752,345
Losses incurred	$8,684,770	
Loss adjustment expenses incurred	3,368,266	
Other underwriting expenses incurred	9,054,478	
Total underwriting deductions		(21,107,514)
Net underwriting gain(loss)		$(1,355,169)
Investment Income		
Net investment income earned	$2,358,021	
Net realized capital gains or (losses)	(585,663)	
Net investment gain(loss)		1,772,358
Other Income		
Finance and service charges not included in premium	$ 452,955	
Aggregate write-ins for increase in ledger assets	111,610	
Borrowed money	629,322	
Total other income		1,193,887
Net income before federal income taxes		$1,611,076
Federal income taxes incurred		(321,534)
Net income(loss)		$1,289,542

Capital and Surplus Account

Surplus as regards policyholders, December 31, 1997, per prior report on examination			$10,870,807
	Gains in Surplus	Losses in Surplus	
Net income or loss	$1,289,542	$ -0-	
Net unrealized capital gains or (losses)	-0-	1,112,515	
Change in not-admitted assets	-0-	260,878	
Change due to Rounding	-2-	-0-	
Total gains and losses	$1,289,544	$1,373,393	
Net increase (decrease) in surplus as regards policyholders			(83,849)
Surplus as regards policyholders, December 31, 2001, per report on examination			$10,786,958

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability of $1,720,990 is the same as the $1,720,990 reported by the Company on its 2001 filed annual statement.

The Department's 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 Department's analysis indicated that, in the aggregate, the Company's losses and loss adjustment expense reserves were adequate.

The Company's actuarial opinion and report were reviewed and utilized in the determination of an appropriate reserve for the Company's unpaid losses and loss adjustment expenses.

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 policyholders and claimants. The review was general in nature and is not to be construed to encompass the generally more precise scope of a market conduct investigation.

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

A. Sales and advertising
B. Underwriting
C. Rating
D. Treatment of policyholders and claimants

The Company's procedures for canceling agents' agreements were reviewed where upon it was determined that the Company was not following Section 2112(d) of the New York Insurance Law, which states, in part, " Every insurer, … upon termination of the certificate of appointment of any insurance agent… file with the superintendent a statement, … of the facts relative to such termination…" The company was unable to provide AGT-1's, termination of agent forms, for ten of eleven terminations for the period January 1998 through December 31, 2001. Therefore, it is recommended that the Company comply with Section 2112(d) of the Insurance Law and file a notice of termination with the superintendent for all cancelled agents.

It was learned through the review of the Company's Anti-Arson Application Procedures that when a renewal policy is cancelled for failure of the insured to return the anti-arson application within the required time limits that no statutory reason is stated on the cancellation notice. However, the following is typed out on the cancellation, " Failure to complete and submit State of New York Anti Arson Application (NYFA-1)." Regulation 96(NYCRR Part 62-4.2(b) requires that a statutory reason be given in accordance with Section 3425(c)(2)(F) and 3426(c)(1)(G) of the New York Insurance Law.

Therefore, it is recommended that the Company comply with Regulation 96(NYCRR Part 62-4.2(b) and include the statutory reason when canceling a policy for failure to return an anti arson application.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

Item	Page No.
A. It is recommended that the Company adhere to all the provisions of its by-laws, henceforth.	5

The Company substantially complied with this recommendation.

B. It is recommended that the Company comply with Section 6611(a)(4) (C) of the New York Insurance Law with regard to having the required number of officers' signatures on all Company checks	10

The Company has complied with this recommendation.

C. It is recommended that the Company comply with Section 1209(f) of the New York Insurance Law and not pay officers or directors compensation which is based upon the earnings of the Company.	11

The Company has complied with this recommendation.

D. It is recommended that the Company develop a written disaster/backup and recovery plan in order to strengthen its electronic data processing department controls. 11

The Company has complied with this recommendation.

E. It is recommended that the Company accurately complete Section P of future annual statements filed with this Department in accordance with the annual statement instructions. 12

The Company has complied with this recommendation.

F. It is recommended that when sending out notices of termination of agents' or brokers' contracts or accounts and when issuing cancellation or non-renewal notices to insureds, the Company ensure that all of the requirements of Department Regulation 90 are complied with, henceforth. 19

The Company has complied with this recommendation.

G. It is recommended that the Company comply with all the provisions of Regulation 96. 20

The Company has materially complied with this recommendation.

See Item 6 of this report

H. It is recommended that the Company comply with Section 6615(a)(1), 6615(a)(3) and Section 2324 of the New York Insurance Law, by discontinuing the use of loss free credits, henceforth. 21

The Department has modified it opinion and the Company is now in compliance with the revised Department position.

I. It is recommended that the Company comply with Section 6615(a)(1) of the New York Insurance Law in the future and charge the rates approved by the board of directors, which should be sufficient to cover all expenses and obligations incurred during the year for which the assessment is levied. 22

The Company has complied with this recommendation.

J. It is recommended that the Company comply with all the provisions of Section 3425 and 3426 of the New York Insurance Law. 23

The Company has complied with this recommendation.

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

The following is a summary of comments and recommendations made in the body of this report:

Item	Page No.
A. Management	
i. It is recommended that Director Erland E. Kainbourne should either improve his attendance at board meetings or be replaced by the policyholders.	5
ii. It is recommended that the Company comply with Article IV Section I of its by-laws by having all members of the board maintain a policy with the Company.	5
B. Holding Company System	
It is recommended that the Company comply with both Regulation 30(NYCRR Part 109.2) and the terms of the Expense Sharing Agreements and develop a method of allocation that will more accurately reflect the employees' actual work expenses with respect to the Monroe Co-operative Fire Insurance Company.	9
C. Market Conduct Activities	
i. It is recommended that the Company comply with Section 2112(d) of the Insurance Law and file a notice of termination with the superintendent for all cancelled agents.	15

ii. It is recommended that the Company comply with Regulation 96(NYCRR Part 62-4.2(b) and include the statutory reason when canceling a policy for failure to return an anti arson application. 16

Respectfully submitted,

/S/

Gerard Franco
Senior Insurance Examiner

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

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

/S/

Gerard Franco
Senior Insurance Examiner

Sworn to before me this

26th day of November, 2002

/S/

Notary Public

CAROLYN D. GRESSICK
Notary Public, State of New York
No. 4658907
Qualified in Montgomery County
Commission Expires October 31, 2005

Appointment No 21905

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:*

Gerard Franco

as proper person to examine into the affairs of the

Allegany Co-op Insurance Company

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

Company

with such other information as he shall deem requisite.

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

this 11th *day of* June, 2002

Gregory V. Serio
Superintendent of Insurance