

REPORT ON EXAMINATION  
OF THE  
AMERICAN COLONIAL INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2001

DATE OF REPORT:

JULY 1, 2002

EXAMINER:

JAMES MURPHY

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

July 1, 2002

Honorable Gregory Serio  
Superintendent of Insurance  
Albany, New York 12257

Sir:

Pursuant to instructions contained in Appointment No. 21897, dated June 5, 2002 and attached hereto, I have made an examination of the conditions and affairs of American Colonial 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 95 Route 17 South, Paramus, New Jersey 07653.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate the American Colonial Insurance Company. Wherever the designation "the Department" appears herein without qualification, it should be understood to indicate the New York Insurance Department.

## 1. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 1997. This examination covers the 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 cash and invested assets, reinsurance recoverables on loss and loss adjustment expenses, loss and loss adjustment expense reserves and federal and foreign income taxes. The examination included a review of income, disbursements and Company records deemed necessary to accomplish such analysis or verification and utilized, to the extent considered appropriate, work performed by the Company's independent public accountants. A review 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
- Company records
- Fidelity bonds and other insurance
- Territory and plan of operation
- Growth of the Company
- Business in force
- Loss experience
- Reinsurance
- Market conduct activities
- Accounts and records
- Financial statements

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

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

## 2. DESCRIPTION OF COMPANY

The Company was incorporated under the laws of the State of New York on January 6, 1981. It was licensed and commenced business on June 30, 1981. In an agreement, dated December 31, 1989, the Company agreed to cease writing any new or renewal business effective March 1990.

### A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of at least thirteen directors. The Company holds its annual meeting in June. Meetings of the board are held quarterly.

As of December 31, 2001, the fifteen directors of the Company were as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Peter K. Barbano Montville, NJ	Vice President and Secretary, Preserver Group
George P. Farley Tenafly, NJ	Retired
Robert S. Fried West Orange, NJ	Retired
Malcolm Galatin Tenafly, NJ	Professor of Economics, City College New York
Stephen A. Gilbert North Bergen, NJ	Co-Chief Executive Officer, General Counsel and President, Preserver Group
Patrick J. Haveron Old Tappan, NJ	Co-Chief Executive Officer, Executive Vice President and Chief Financial Officer, Preserver Group

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
William E. Lobeck, Jr. Tulsa, OK	Stockholder, Preserver Group
Archer McWhorter Houston, TX	Chairman of the Board, Preserver Group
Archer McWhorter, Jr. Houston, TX	Associate Professor, University of Houston
George B. Patterson Denville, NJ	Vice President-Marketing, Preserver Group
Charles J. Pelosi Piscataway, NJ	Vice President-Information Services, Preserver Group
Patrick J. Phillips Saratoga Springs, NY	Underwriter, Preserver Group
Myron Rogow New City, NY	Vice President-Underwriting, Preserver Group
Alvin E. Swanner Kenner, LA	Stockholder, Preserver Group
John F. Templer Schenectady, NY	Underwriter, Preserver Group

The examiner's review of the minutes of the meetings of the board of directors and its committees indicated that meetings were well attended.

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

<u>Name</u>	<u>Title</u>
Stephen A. Gilbert	President
Patrick J. Haveron	Executive Vice President, Chief Financial Officer
Peter K. Barbano	Secretary

B. Territory and Plan of Operation

As of December 31, 2001, the Company was licensed in New York and Texas. In addition, the Company is licensed as a surplus lines carrier in the state of Maine and the District of Columbia. The Company has been in run-off status since 1990.

The Company is authorized to transact the following kinds of business as set forth in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

<u>Paragraph</u>	<u>Line of Business</u>
4	Fire
5	Miscellaneous property
6	Water damage
12	Collision
13	Personal injury liability
14	Property damage liability
19	Motor vehicle and aircraft
20	Marine

Based upon the lines of business for which the Company is licensed, and the Company's current capital structure, and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders, as defined in Section 4103 of the Insurance Law, in the amount of \$600,000.

C. Reinsurance

Due to the Company's runoff status, there is no reinsurance program in effect as of the examination date.

D. Holding Company System

The Company is a wholly-owned subsidiary of North East Insurance Company (“NEIC”). On September 24, 1999, Preserver Group, Inc. (“PGI”), formerly the Motor Club of America, a publicly traded holding company, acquired 100% of the outstanding stock of NEIC. On December 18, 2001, PGI announced a self-tender offer to buy all of its 1,101,510 outstanding public shares for \$7.75 a share. Members of the Executive Committee, representing a group of PGI shareholders and their affiliates owning 1,022,870 shares, funded the transaction through an advance to PGI on an interest free basis. As a result of the transaction, on March 18, 2002, PGI delisted itself from the NASDAQ National Market and became a private company owned by the members of the Executive Committee and their affiliates.

The following is an organizational chart of the holding company system as of December 31, 2001:



The Company and NEIC are parties to a service agreement, effective November 1, 1986, under which NEIC maintains the office, equipment and personnel necessary to conduct the daily business and

operations of the Company. This agreement was submitted to the Department and approved on April 24, 2001.

E. Significant Operating Ratios

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

Net premiums written to surplus as regards policyholders	N/A
Liabilities to liquid assets	16%
Premiums in course of collection to surplus as regards policyholders	N/A

The second ratio falls within the benchmark range set forth in the Insurance Regulatory Information System (“IRIS”) of the National Association of Insurance Commissioners. Due to the run-off status of the Company, the premium based IRIS ratios do not represent meaningful information and, therefore, were not computed.

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

	<u>Amounts</u>	<u>Ratios</u>
Losses incurred	\$(1,370,817)	(344.17)%
Loss adjustment expenses incurred	215,900	54.21
Other underwriting expenses incurred	324,209	81.40
Net underwriting gain	<u>834,691</u>	<u>209.56</u>
Premiums earned	<u>\$ 3,983</u>	<u>100.00%</u>

F. Abandoned Property Law

Section 1316 of the captioned law requires companies to file an abandoned property report with the Office of the Comptroller by April 1 of each year. The Company did not make the required filings.

It is recommended that the Company comply with Section 1316 of the New York Abandoned Property Law. The prior report on examination contained a similar comment and the Company has failed to comply.

### 3. FINANCIAL STATEMENTS

#### A. Balance Sheet

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

	<u>Ledger Assets</u>	Non-Ledger <u>Assets</u>	Non- Admitted <u>Assets</u>	Net-Admitted <u>Assets</u>
<u>Assets</u>				
Bonds	\$6,643,010	\$	\$	\$6,643,010
Cash	442,023			442,023
Reinsurance recoverables on loss and loss adjustment expense payments	39,148			39,148
Federal and foreign income taxes recoverable and interest thereon	26,016		26,016	
Interest, dividends and real estate income due and accrued due and accrued	90,334			90,334
Receivable from parent, subsidiaries and affiliates	<u>31,480</u>	_____	_____	<u>31,480</u>
Total assets	<u>\$7,272,011</u>	<u>\$</u>	<u>\$ 26,016</u>	<u>\$7,245,995</u>

Liabilities

Losses		\$520,244
Loss adjustment expenses		140,953
Federal and foreign income taxes		149,775
Ceded reinsurance premium balances payable		9,660
Funds held by company under reinsurance treaties		297,025
Provision for reinsurance		<u>16,658</u>
Total liabilities		\$ 1,134,315

Surplus as Regards Policyholders

Common capital stock	500,000	
Gross paid-in and contributed surplus	4,339,050	
Unassigned funds	<u>1,272,630</u>	
Surplus as regards policyholders		<u>6,111,680</u>
Total liabilities and surplus		<u>\$7,245,995</u>

Note: The Internal Revenue Service has never audited the Company. The examiner is unaware of any potential exposure of the Company to any income tax assessment and no liability has been established herein.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$942,710 during the four-year examination period from January 1, 1998 through December 31, 2001 detailed as follows:

Statement of Income

Underwriting Income

Premiums earned		\$3,983
Deductions:		
Losses incurred	\$(1,370,817)	
Loss adjustment expenses incurred	215,900	
Other underwriting expenses incurred	<u>324,209</u>	
Total underwriting deductions		<u>\$(830,708)</u>
Net underwriting gain		\$834,691

Investment Income

Net investment income earned	\$1,862,292	
Net realized capital gains (losses)	<u>(9,918)</u>	
Net investment gain		1,852,374

Other Income

Net gain or loss from premium balances charged off	\$(26,610)	
Miscellaneous income	<u>7,500</u>	
Total other income		<u>(19,110)</u>

Net income before federal and foreign income taxes		\$2,667,955
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Federal and foreign income taxes		<u>392,038</u>
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Net income		<u>\$2,275,917</u>
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Capital and Surplus Account

Surplus as regards policyholders, per report on examination as of December 31, 1997			\$5,168,970
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$2,275,917	\$	
Net unrealized capital gains	62,689		
Change in provision for reinsurance	20,342		
Change in non-admitted assets	13,365		
Change in net deferred income tax		13,365	
Dividends to stockholders	<u>                    </u>	<u>1,416,238</u>	
Total gains and losses	<u>\$2,372,313</u>	<u>\$1,429,603</u>	
Net increase in surplus as regards policyholders			<u>942,710</u>
Surplus as regards policyholders, per report on examination as of December 31, 2001			<u>\$6,111,680</u>

**4. LOSS AND LOSS ADJUSTMENT EXPENSES**

The examination liabilities for losses and loss adjustment expenses of \$520,244 and \$140,953, respectively, are the same as the amounts reported by the Company as of the examination date. The 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.

It was noted that the number of claims outstanding on Schedule P, Part 1, Columns 13 and 26, and Schedule P, Part 3, Columns 12 and 13 were not included in the Company's filed annual statement.

It is recommended that the Company indicate the number of claims outstanding on Schedule P, Part 1, Columns 13 and 26 and Schedule P, Part 3, Columns 12 and 13, as required by the Annual Statement Instructions published by the National Association of Insurance Commissioners. The prior report on examination contained a similar comment and the Company has failed to comply.

## **5. MARKET CONDUCT ACTIVITIES**

In the course of the 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, which is the responsibility of the Market Conduct Unit of the Property Bureau.

Since the Company is in runoff status, the general review was directed at the Company's practices relative to claims settlement and complaints. No problem areas were noted.

## **6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION**

Following are the violations, recommendations and comments contained in the prior report on examination and the subsequent actions taken by the Company in response to each citation:

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
i.        It is again recommended that the Company comply with its by-laws by maintaining thirteen members of the board of directors.	4

<u>ITEM</u>	<u>PAGE NO.</u>
The Company has complied with this recommendation.	
ii. It is recommended that the Company comply with Section 1201(a)(5)(B)(vi) of the New York Insurance Law and maintain not less than three directors who are New York residents.	4
The Company has complied with this recommendation.	
iii. It is again recommended that the board meet regularly as provided by the corporate charter and by-laws to discuss policy issues that may effect the Company.	4
The Company has complied with this recommendation.	
iv. It is again recommended that the result of security investment activities be presented to the board of directors during the meeting for approval pursuant to Section 1411(a) of the New York Insurance Law.	5
The Company has complied with this recommendation.	
v. It is recommended that the three new members of the board of directors submit their biographical questionnaires to the New York State Insurance Department in Albany for evaluation and review.	5
The Company has complied with this recommendation.	
vi. It is recommended that the Company maintain completed conflict of interest questionnaires for all officers, directors and key employees on an annual basis.	5
The Company has complied with this recommendation.	
B. <u>Territory and Plan of Operation</u>	
It is recommended that the Company maintain an office in New York State to comply with the provisions of Section 325 of the New York Insurance Department.	7
The Company has complied with this recommendation.	
C. <u>Holding Company System</u>	
i. It is again recommended that the Company comply with the provisions of Article 15 of the New York Insurance Law and Department Regulation 52, by filing Form HC-1 with the Department within 120 days of the end of its holding company's fiscal year.	8

<u>ITEM</u>	<u>PAGE NO.</u>
	The Company has complied with this recommendation.
ii.	9-10
	It is recommended that the service and expense sharing agreement between North East Insurance Company and American Colonial Insurance Company be filed and approved by the Department before being implemented.
	The Company has complied with this recommendation.
D.	10
	<u>Corporate Emergency Measures</u>
	It is again recommended that the Company adopt a formal corporate emergency plan for the conduct of business, protection of records and continuity of management in case of a catastrophic event.
	The Company has complied with this recommendation.
E.	10-11
	<u>Abandoned Property Law</u>
	It is again recommended that the Company comply with Section 1316 of the Abandoned Property Law of New York State.
	The Company has not complied with this recommendation and a similar comment is contained in this report.
F.	14-15
	<u>Losses</u>
	It is recommended that the Company indicate the number of claims outstanding on Schedule P, Part 1, Columns 12 and 13, as required by the Annual Statement Instructions published by the National Association of Insurance Commissioners.
	The Company has not complied with this recommendation and a similar comment is contained in this report.

**7. SUMMARY OF COMMENTS AND RECOMMENDATIONS**

The following are the recommendations and comments contained in this report:

<u>ITEM</u>		<u>PAGE NO.</u>
A.	It is again recommended that the Company comply with Section 1316 of the Abandoned Property Law of New York State.	8
B.	It is again recommended that the Company indicate the number of claims outstanding on Schedule P, Part 1, Columns 13 and 26 and Schedule P, Part 3, Columns 12 and 13, as required by the Annual Statement Instructions published by the National Association of Insurance Commissioners.	13



Appointment No 21897

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:

**James Murphy**

as proper person to examine into the affairs of the

**American Colonial 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 5th day of June, 2002

  
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GREGORY V. SERIO  
Superintendent of Insurance

