# REPORT ON EXAMINATION

# OF THE

# COMMERCIAL MUTUAL INSURANCE COMPANY

# AS OF

# DECEMBER 31, 2001

DATE OF REPORT NOVEMBER 15, 2002

EXAMINER JIMMIE NEWSOME

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GEORGE E. PATAKI
Governor

STATE OF NEW YORK
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NEW YORK, NEW YORK 10004

GREGORY V. SERIO
Superintendent of Insurance

November 15, 2002

Honorable Gregory V. Serio

Superintendent of Insurance

Albany, New York 12257

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 21838 dated February 21, 2002, attached hereto, I have made an examination into the condition and affairs of the Commercial Mutual 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 15 Joys Lane, Kingston, New York 12401.

Wherever the Designation "the Company" or "CMIC" appears herein without qualification, it should be understood to indicate the Commercial Mutual Insurance Company.

## 1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1996. This examination covers the five-year period from January 1, 1997, through December 31, 2001. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination comprised a verification of assets and liabilities as of December 31, 2001, a review of income and disbursements deemed necessary to accomplish such verification, and utilized, to the extent considered appropriate, work performed by the Company's independent certified public accountants. A review or audit was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners:

History of the Company
Management and control
Corporate records
Fidelity bonds and other insurance
Officers' and employees' welfare and pension plans
Territory and plan of operation
Growth of 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 in the prior report on examination.

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

## 2. DESCRIPTION OF COMPANY

The Company was incorporated under the laws of New York as the Co-operative Fire Insurance Company of Greene, Schoharie, and Delaware Counties in 1886. The Company was organized for the purpose of transacting business as a co-operative fire insurance company in said counties.

In November 1922, a certificate was issued by the Insurance Department authorizing the Company to change its name to The Co-operative Fire Insurance Company of Catskill, New York. Subsequently, the Company's charter was amended permitting it to extend its territory to include the entire State of New York and, wherever authorized by law, any other state of the United States of America and the District of Columbia.

On June 1, 1935, the Company assumed all of the assets and liabilities of the Commercial Mutual Fire Insurance Company of Greene County pursuant to a reinsurance agreement approved by the Insurance Department.

Under the terms of a reinsurance and assumption agreement approved by the Insurance Department in July 1956, with three other advance premium companies participating equally, the entire in-force business of the Oneida Co-operative Fire Insurance Association of Rome, New York was ceded over. The corporate existence of the latter company was terminated and subsequent to an Order of Liquidation and Distribution signed December 8, 1959, the Insurance Department approved distribution of the balance in the Oneida bank account to the four participating companies in March 1960.

On April 5, 1976 the Company filed with the Superintendent of Insurance, a Certificate of Amendment of Charter, as amended, in compliance with Section 1206 of the New York Insurance Law. Such certificate amends its charter and license to reflect the name change from

The Co-operative Fire Insurance Company of Catskill, New York to Commercial Mutual Insurance Company. This amendment was approved by the Insurance Department on April 20, 1976.

The Company's charter was originally filed in the office of the Superintendent of Insurance of the State of New York on July 31, 1886, as restated effective February 21, 1955, as amended April 20, 1976, June 8, 1979 and December 8, 1999.

A. Management

The by-laws, as amended, provide that the business and affairs of the company shall be managed and controlled by a board of directors, consisting of not less than eleven nor more than thirteen members. As of the examination date, the board of directors was comprised of eleven members. Each of the director's qualifications, as set forth in Article II Section 1 of its by-laws, was reviewed and it appears that each director was duly qualified. The directors as of December 31, 2001, were as follows:

| Name and Residence | Principal Business Affiliation |
|---|---|
| Paul M. Alliegro<br>Bayport, New York | Vice President<br>Eagle Insurance Group |
| Simha Chandran<br>Forest Hills, New York | Finance Manager<br>Robert Plan Corporation |
| Lisa G. Drillich<br>Hewlett, New York | Corporate Secretary<br>Commercial Mutual Insurance Company |
| Kenneth J. Karasinski<br>Marion, New York | Corporate Director of Claims<br>Robert Plan Corporation |
| John L. Lusardi<br>Woodbury, New York | Senior Vice President<br>Robert Plan Corporation |
| Philbert A. Nezamoodeen<br>East Rockaway, New York | President<br>Eagle Insurance Company |

| Name and Residence | Principal Business Affiliation |
|---|---|
| Stephen F. Paparo<br>Fort Salonga, New York | Senior Vice President<br>Robert Plan Corporation |
| John D. Reiersen<br>Port Jefferson, New York | President and CEO<br>Commercial Mutual Insurance Company |
| David C. Smith<br>East Greenbush, New York | Treasurer and CFO<br>Commercial Mutual Insurance Company |
| Sally A. Udalovas<br>Eatons Neck, New York | Vice President<br>Robert Plan Corporation |
| Robert M. Wallach<br>Mill Neck, New York | Chairman, President and CEO<br>Robert Plan Corporation |

The minutes of all meetings of the board of directors and committees thereof held during the examination period were reviewed to determine if each director is willing and maintaining an active role into the corporate management of Commercial Mutual Insurance Company. Overall, the attendance of the board of directors was adequate during the period of examination with the exception of the following four (4) directors: Robert Wallach, Kenneth Karasinski, Simha Chandran and John Lusardi. During that period Mr. Wallach and Mr. Karasinski served on the Board of Directors for four years, attending 27% and 45% of the meetings, respectively. Mr. Chandran and Mr. Lusardi missed the two meetings they were eligible to attend.

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. Individuals who fail to attend at least one-half of the regular meetings do not fulfill such criteria. Board members who are unable or unwilling to attend meetings consistently should resign or be replaced.

The Company is not in compliance with its by-laws, wherein Section 2 of Article II states, "the annual meeting of the board of directors shall be held immediately after the annual meeting of the company. Three other regular meetings shall be held in each calendar year." It was noted that the board of directors did not hold the required number of meetings pursuant to such provision three out of the five years covered by this examination.

In addition, the Company is not in compliance with Section 6624(b)(1) of the New York Insurance Law, which states,

"The board of directors of every co-operative property/casualty insurance company shall hold regular meetings at least four times in each calendar year."

The failure of the board of directors to hold regularly scheduled meetings precludes the directors from discharging their fiduciary responsibilities with respect to oversight of the Company.

It is recommended that the board of directors hold the requisite number of regular meetings as set forth in the Company's by-laws and pursuant to the provisions of Section 6624 (b)(1) of the New York Insurance Law.

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

| Name | Title |
|---|---|
| Robert M. Wallach | Chairman and Chief Executive Officer |
| John D. Reiersen | President and Vice Chairman |
| David C. Smith | Vice President and Treasurer |
| Hylan T. Hubbard | Vice President and Chief Operating Officer |
| Philbert Nezamoodeen | Vice President |
| Kenneth Karasinski | Vice President |
| Lisa G. Drillich | Secretary |

1. Conflict of Interest

The Company has a procedure to distribute conflict of interest questionnaires to its board of directors, executive officers and to all employees on a yearly basis. The Company's President has the discretion to eliminate certain classes of employees from the requirement of submitting the annual questionnaire. A review of the Company's records was made for the period covered by this examination. The Company was unable to provide conflict of interest questionnaires for several directors. This review was confined to the board of directors listed in the annual statements covered by this examination period.

It is recommended that the Company exercise due care in obtaining and maintaining signed conflict of interest questionnaires from its board of directors, officers and employees.

B. Territory and Plan of Operation

As of the December 31, 2001, Commercial Mutual Insurance Company was licensed to transact business as an advance premium co-operative fire insurance company within the State of New York. As of the examination date, the Company was only licensed in the State of New York.

The amount of direct premiums written during the period covered by this examination is detailed as follows:

| Year | Direct Premium Written |
|---|---|
| 1997 | $9,833,258 |
| 1998 | $8,598,589 |
| 1999 | $11,032,372 |
| 2000 | $10,373,590 |
| 2001 | $9,319,598 |

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

| Paragraph | Kind of Insurance |
|---|---|
| 4 | Fire |
| 5 | Miscellaneous Property Damage |
| 6 | Water Damage |
| 7 | Burglary and Theft |
| 8 | Glass |
| 12 | Collision |
| 13 | Personal Injury Liability |
| 14 | Property Damage Liability |
| 19 | Motor Vehicle and Aircraft Physical Damage |
| 20 | Marine and Inland Marine |

The Company is also authorized to accept reinsurance of the kind or kinds of insurance it is licensed to do directly, and to cede reinsurance pursuant to the provisions of Section 6606 of the New York Insurance Law.

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 Article 13, 41 and 66 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of $603,726.

Commercial Mutual Insurance Company writes homeowners and landlord package policies in New York State. In 2001, the Company began to reduce its writings of landlord policies to concentrate on writing personal lines products. In 2002, the Company began writing commercial auto liability and physical damage coverage. Business is written through approximately 80 independent agents.

The Company's current book of business consists primarily of homeowners and commercial auto risks. The Company participated to the extent of one-third share of the New York Mutual Underwriters ("NYMU"). Effective November 1, 1997, the Company's participation percentage dropped to zero and the Company will only be participating in losses

and loss adjustment expenses that occurred prior to such date. The unearned premium reserve of Commercial was ceded to other carriers when it was disbanded.

C. Reinsurance

The Company assumed no business during the period covered by this examination. The Schedule F as contained in the Company's 2001 filed annual statement was found to accurately reflect its reinsurance transactions.

The examiners reviewed all 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.

During the period covered by this examination, the Company had the following general working excess of loss reinsurance program in place:

| | |
|---|---|
| Property 3 Layers | $1,750,000 in excess of $250,000 each and every risk, each and every occurrence |
| Casualty 3 Layers | $1,750,000 in excess of $250,000 each and every risk, each and every occurrence |

This agreement was terminated effective January 1, 2001 on a run-off basis.

The Company also maintained a property catastrophe excess of loss reinsurance on a per occurrence basis covering 95% of net losses up to $1,500,000 in excess of $1,000,000; not to exceed 95% of $3,000,000 with respect to all loss occurrences during the agreement term. This agreement was not renewed upon expiration on July 1, 2001.

Commencing April 1, 1998, the Company effected a personal lines quota share agreement, whereby it ceded 95% of its net liability to authorized reinsurers up to $5,000,000 for property business and $1,000,000 for casualty business. It was noted that this agreement was terminated September 1, 2001 on a run-off basis. However, it appears that there is a potential

dispute with one reinsurer under this contract with regards to the termination date. The termination date for this reinsurer may in fact be July 1, 2001. The Company has quantified the net effect of terminating July 1, 2001 versus September 1, 2001 as of December 31, 2001 to be $49,676 due to Commercial, excluding IBNR. Such amount is not considered material by this examination.

On April 1, 1998, the Company effected a net loss quota share agreement with its affiliate, Eagle Insurance Company whereby it ceded 50% of its net retained liability. Effective January 1, 1999, the cession increased to 90%. Eagle Insurance Company and the Company agreed that this agreement would be terminated effective December 31, 2001, on a run-off basis.

Section 1308(e)(1)(A) of the New York Insurance Law states,

"During any period of twelve consecutive months, without the superintendent's permission: no domestic insurer, except life, shall by any reinsurance agreement or agreements cede an amount of its insurance on which total gross reinsurance premiums are more than fifty percent of the unearned premiums on the net amount of its insurance in force at the beginning of such period…"

The Department granted approval for the Company to cede an amount in excess of the 50% limitation prescribed by Section 1308(e)(1)(A) of the New York Insurance Law, in 1982. However, during the period covered by this examination, the Company failed to submit to the Department for review, various reinsurance agreements and subsequent amendments to the reinsurance agreements as required by Section 1308(e)(1)(A) of the New York Insurance Law.

It is recommended that the Company comply with the requirements of Section 1308(e)(1)(A) of the New York Insurance Law.

It is noted that the examination of the reinsurance agreements effected during the examination period was impeded by the inability of the Company to provide complete contracts upon initial request. Agreements were provided, in some cases, piecemeal and only upon the request for additional documentation were the agreements complete including addenda and the signed interest and liabilities of the various reinsurers.

It is recommended that the Company comply with Section 6611(a)(1) of the New York Insurance Law and maintain complete copies of all reinsurance contracts to which it is a party. Such contracts should be readily available upon examination.

D. Holding Company System

The Robert Plan Corporation is the ultimate parent in the holding company system. Members of the holding company system are detailed in the Holding Company – Organizational Chart, appended to this report. As of December 31, 2001, William Wallach and Frances Wallach are the record holders of approximately 83% and 12% respectively of the presently issued and outstanding shares of the Robert Plan Corporation. No other person beneficially owns more than 5% of the presently issued and outstanding shares of The Robert Plan Corporation.

The Robert Plan Corporation owns 100% of the stock of Eagle Insurance Company, which has a controlling interest in the Company by way of surplus notes, the board of directors, policy administration and servicing agreements, and reinsurance agreements. On April 1, 1998 Eagle Insurance Company invested $3 million in the company in the form of a surplus note. On March 12, 1999, Eagle Insurance Company purchased another surplus note in the amount of $750,000.

The Company did not report certain transactions with its affiliates as per the requirements of Sections 1505(c) and 1505(d) of the New York Insurance Law and Section 80-1.5 of Department Regulation No. 52 in a timely manner.

It is recommended that the Company adhere to the provisions of Sections 1505(c) and 1505(d) of the New York Insurance Law and Section 80-1.5 of Department Regulation No. 52 with respect to reporting transactions with affiliated companies.

The following is a summary of each inter-company agreement in effect as of December 31, 2001:

1. 90% Quota Share Reinsurance Agreement

On January 1, 1999, the Company entered into a 90% quota share reinsurance agreement with its affiliate, Eagle Insurance Company ("Eagle"), which the Insurance Department stated its non-objection to on May 13, 1999. Under the terms of the agreement, the Company cedes to Eagle a 90% share of the net retained liability of the Company under each and every policy covered hereunder. Such agreement was terminated as of December 31, 2001.

2. Policy Administration and Servicing Agreement

On January 1, 1999, the Company entered into a policy administration and servicing agreement with its affiliate Colonial Indemnity Insurance Company ("Colonial"), which was conditionally non-objected to by the Insurance Department on September 13, 1999. Under the terms of the agreement, Colonial agrees to provide administration and services, including underwriting, for all policies written by the Company, processing applications for insurance, collecting premium balances, rating, quoting and issuing policies, developing and maintaining proper underwriting files.

Upon review of the Policy Administration and Servicing Agreement with Colonial Indemnity Insurance Company, it was noted that such agreement does not include a provision for the settlement of accounts. The Insurance Department's non-disapproval of this agreement was conditional, provided that the Company included such provision. The Company has not complied with the conditional non-disapproval of the Insurance Department. When this matter was brought to the Company's attention, they indicated that the account is settled on an annual basis. However, it was noted that the settlement of the 2001 year-end balance of $30,600 was not made until September 18, 2002.

It is recommended that going forward the Company comply with all conditional non-disapprovals of the Insurance Department.

3. Claims Service Agreement (Pre May 1, 1998 Claims)

On May 1, 1998, the Company entered into a claims service agreement with its affiliate Material Damage Adjustment Corp. ("MDA"), which was non-objected to by the Insurance Department on September 13, 1999. Under the terms of the agreement, MDA agrees to handle claims and claims legal administration for claims on losses occurring prior to May 1, 1998. MDA shall provide complete claims administration and claims legal administration services for all claims made under insurance policies issued by the Company and which are incurred prior to May 1, 1998. MDA shall bear and pay all allocated and unallocated expenses of providing such services.

4. Claims Service Agreement (Post May 1, 1998 Claims)

On May 1, 1998, the Company entered into a claims service agreement with its affiliate Material Damage Adjustment Corp. ("MDA"), which was non-objected to by the Insurance Department on September 13, 1999. Under the terms of the agreement, MDA agrees to handle

claims and claims legal administration for claims on losses occurring on or after May 1, 1998. MDA shall provide complete claims administration and claims legal administration services for all claims made under insurance policies issued by the Company and which are incurred on or after May 1, 1998. MDA shall bear and pay all allocated and unallocated expenses of providing such services.

Such agreements were cancelled effective December 31, 2001 with MDA still responsible for handling claims with accident dates prior to January 1, 2002. The Company is holding funds due to MDA for their services on a deferral basis. MDA will also handle claims for the company's general liability business, which is currently being run-off.

Upon review of the Claims Service Agreements with MDA, it was noted that such agreements included a provision for the settlement of the fees to be paid by the Company to MDA. However, as per the agreement, the fees shall be adjusted on an annual basis, based on an analysis of the actual cost of providing the services, with the first adjustment as of December 31, 1999. It was noted that the first adjustment was not made until as of December 31, 2001. Settlement of the net balance payable to MDA in the amount of $345,560, for the expenses from the inception of the agreement, was made on February 8, 2002.

It appears that the Company is not settling inter-company balances in accordance with the agreements or in timely manner. Also, it appears that settlement is not made until there is a payable to MDA. As per the 2000 filed annual statement, the Company had a receivable from MDA in the amount of $252,027 which was never settled and should have been non-admitted (since it was not received within 90 days). However, such receivable was netted against expenses in the following year, resulting in a payable to MDA and payment of such being made.

It is recommended that the Company adhere to the provisions of the Claims Service Agreement with MDA and adjust the fees payable to MDA to actual cost on an annual basis.

It is recommended that the Company settle these accounts in a timely manner pursuant to the provisions of such agreements.

Subsequent to the examination date, the Company entered into Expense Sharing Agreements with Colonial Indemnity Insurance Company and The Robert Plan of New York Corporation effective January 1, 2002. It was noted that the Policy Administration and Servicing Agreement with Colonial Indemnity Insurance Company has been amended and restated as of January 1, 2002, and renamed as the above-mentioned Expense Sharing Agreement.

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 | .13:1 |
| Liabilities to liquid assets (cash and invested assets less investment in affiliates) | 107.61% |
| Agents' balances or uncollected premiums to surplus | 17.93% |

The above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners with the exception of the Liabilities to Liquid Assets.

This was primarily due to non-affiliated invested assets falling short of current liabilities. Significant underwriting losses were experienced over the period covered by this examination that outweighed investment income. Liquidity has also been impacted by consecutive years of negative cash flows from operations.

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

| | Amounts | Ratios |
|---|---|---|
| Losses and LAE Incurred | $9,608,030 | 135.59% |
| Other Underwriting Expenses Incurred | 423,850 | 5.98% |
| Net Operating Gain (or Loss) | (2,945,991) | (41.57)% |
| Premiums and Fees Earned | $7,085,889 | 100.00% |

F. Abandoned Property Law

A review was made of the information included in the Company's filed Abandoned Property Reports with the Office of the Comptroller of the State of New York. The examiners also reviewed the Company's accounting policy and procedures with respect to all unclaimed checks. It appears that the Company has adequate controls in maintaining the accountability of all unclaimed checks.

In conclusion, the Company appears to be complying with Section 1316 of the New York Abandoned Property Law with regard to filing such reports.

G. Accounts and Records

During the period under examination, the examiners noted the following deficiencies in the Company's system of account and records:

1. Authorized Signatories

It was noted during the review of the custodian agreement and the investment management account with Trustco Bank and Fleet National Bank, respectively that the corporate resolutions did not reflect the current officers authorized to act on the Company's behalf. The corporate resolutions indicated officers who were no longer employees of the Company. When this matter was brought to the Company's attention, they indicated that corrective measures would be taken at the next board of directors' meeting. Subsequent to the examination date, the

Company provided the examiners with documentation amending its corporate resolution with Fleet National Bank to reflect the current officers authorized to act on behalf of the Company.

It is recommended that the Company amends its corporate resolutions with the Trustco Bank to accurately reflect the current officers authorized to act on the Company's behalf.

2. Surplus Notes

At December 31, 2001, the Company has two surplus notes in the amounts of $3,000,000 and $750,000 that met the Department's criteria for a Section 1307 subordinated loan.

As per the filed 2001 Annual Statement's Financial Note #13, the Company issued two surplus notes to Eagle Insurance Company at an interest rate of 8.5% per annum. However, the surplus note agreements states in part,

"Interest shall accrue on the outstanding principal amount at an annual rate equal to the lesser of: (a) 8.5% per annum, (b) the prime rate charged from time to time by Citibank, N.A. or (c) that rate permitted pursuant to the provisions of Section 5-501 of the General Obligations Law of the State of New York."

It appears that the interest accrued on the surplus notes was not in accordance with the provisions of such agreements. When this matter was brought to the Company's attention, they indicated that the interest was accrued using 8.5% per annum.

In addition, the Company's filed 2001 annual statement did not contain the required footnote as per Section 1307(c) of the New York State Insurance Law.

Section 1307(c) of the Insurance Law states,

"Any sum so advanced or borrowed shall not be part of the legal liabilities of such insurer and shall not be a basis of any set-off but until repaid all statements published by such insurer or filed with the superintendent shall show, as a footnote, the amount then remaining unpaid."

Accrued interest, however, would be disclosed as part of the standard footnote required under Section 1307(c) of the New York State Insurance Law. This footnote should reads as follows:

Note: No liability appears in the balance sheet for a loan in the amount $_____ and accrued interest thereon in the amount of $_____. This loan was granted pursuant to Section 1307 of the New York State Insurance Law. As provided in Section 1307 repayment of principal and interest shall only be made out of free and divisible surplus, subject to the prior approval of the Superintendent of Insurance of the State of New York.

This footnote should appear at the bottom of Liabilities, Surplus and Other Funds, page 3. A review of the 1998, 1999 and 2000 filed annual statements revealed that the statements did not contain the required footnote.

As of December 31, 2001, Commercial Mutual Insurance Company has Section 1307 loans totaling in the amount of $3,750,000 and accrued interest thereon in the amount of $1,047,813.

It is recommended that the Company comply with the provisions of Section 1307(c) of the Insurance Law, with respect to the loan and the accrued interest being disclosed as part of the standard footnote.

It is also recommended that the Company adhere to the terms of the surplus note agreements when calculating accrued interest on the outstanding principal amount.

3. Special Contingent Surplus

Pursuant to the Section 6604(a)(3) of the New York Insurance Law, the Company is subject to the provisions of Section 4109 of the New York Insurance Law. Section 4109(a) of the New York Insurance Law requires the Company to establish on its general ledger a special contingent surplus and thereafter maintain the same unimpaired so long as it is licensed to write one or more of the casualty lines of business. Section 4109(b) requires the Company, except

during the first two full calendar years following the year in which it was first licensed to write casualty lines, to increase the special contingent surplus each year by an amount at least equal to 1.5% of the net premium income received for the casualty lines it is licensed to write, until the amount of the special contingent surplus is at least equal to the amount of surplus to policyholders required under Section 4103 to be maintained by a similar stock property/casualty insurance company licensed to write the same lines of business.

The special contingent surplus was calculated for each of the years covered by this examination. It appears that the Company is calculating and accumulating the special contingent surplus in accordance with the provisions of Section 4109(b) of the New York Insurance Law. However, the Company erred in 1999 wherein the calculation resulted in negative net premium income and the Company reduced its special contingent surplus by 1.5% contrary to the provisions of Section 4109(b) of the New York Insurance Law. The Company was advised that the special contingent surplus should not decrease; if the calculation results in negative net premium income then the special contingent surplus should remain the same as the prior year end.

It is recommended that the Company calculate and accumulate the special contingent surplus pursuant to the provisions of Section 4109(b) of the New York Insurance Law.

It is recommended that the Company adjust its books and records to reflect the special contingent surplus in the amount of $503,726 as determined by this examination.

4. Overdue Premiums

The examination review of the asset "Agents' Balances or Uncollected Premiums" indicated that the Company's guidelines for determining premiums over 90 days past due is based on the percentage of premium outstanding at year-end. This method is not in accordance

with the guidelines set forth in SSAP No. 6 of the NAIC Accounting Practices and Procedures Manual.

It is recommended that the Company comply with the guidelines pursuant to SSAP No. 6 of the NAIC Accounting Practices and Procedures Manual for determining premiums over 90 days past due.

5. Regulation 30 – Allocation of Expenses

As per the prior report on examination, the Company was directed to establish and maintain written documentation supporting the percentages used to allocate expenses to the major expense groups, as required by Department Regulation 30. The Company performed expense analysis for 1999 but failed to perform the necessary analysis required by this Department's Regulation 30 for 1997, 1998, 2000, and 2001. The Company has indicated that they are aware of the provisions of Department Regulation 30 and plans to perform a Regulation 30 study in Year 2003. The Company has taken the position that performing a Regulation 30 study at this point would be meaningless since they are in the process of separating their operations from the Robert Plan Corporation.

It is recommended that the Company adhere to the provisions of Department Regulation 30 regarding the allocation of expenses between insurance companies and to the major expense groups.

It is recommended that the Company keep in clear and legible form, records of all bases of allocation. Such records should fully disclose the bases and be readily available for examination.

## 3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as determined by this examination as of December 31, 2001. Except as discussed in Note 3, this statement is the same as the balance sheet filed by the Company.

| Assets | Assets | Assets Not Admitted | Net Admitted Assets |
|---|---|---|---|
| Bonds | $1,251,810 | | $1,251,810 |
| Common stocks | 200 | 200 | 0 |
| Cash and short-term investments | 2,731,475 | | 2,731,475 |
| Premiums and Agents' balances in course of collection | 316,486 | 5,612 | 310,872 |
| Premiums, agents' balances and installments booked but deferred and not yet due | 531,532 | | 531,532 |
| Reinsurance recoverable on loss and loss adjustment expense payments | 1,504,370 | | 1,504,370 |
| Interest, dividends, real estate income due & accrued | 30,585 | | 30,585 |
| Equities and deposits in pools and associations | 264,856 | 196 | 264,660 |
| Other assets non-admitted | 30,299 | 30,299 | 0 |
| Total Assets | $6,661,613 | $36,307 | $6,625,306 |

| Liabilities | Amount |
|---|---|
| Losses and Loss adjustment expenses | $2,585,003 |
| Commissions payable, contingent commissions and other similar charges | 15,521 |
| Other expenses | 32,575 |
| Taxes, licenses and fees | 15,800 |
| Federal and foreign income taxes | 13,200 |
| Unearned premiums | 132,521 |
| Ceded reinsurance premiums payable | 891,700 |
| Funds held by company under reinsurance treaties | 8,831 |
| Amounts withheld or retained by company for account of others | 139,661 |
| Provision for reinsurance | 602,800 |
| Payable to parent, subsidiaries and affiliates | 376,160 |
| Advance premiums | 77,516 |
| Total Liabilities | $4,891,288 |
| Surplus and Other Funds | |
| Special contingent surplus | 503,726 |
| Surplus notes | 3,750,000 |
| Unassigned funds (surplus) | (2,519,708) |
| Surplus as regards policyholders | $1,734,018 |
| Total Liabilities and Surplus | $6,625,306 |

Note 1: To date, the Internal Revenue Service has not audited the Company's federal income tax returns. The examiner is unaware of any potential exposure of the Company to any further tax assessment and no liability has been established herein relative to such contingency.

Note 2: No liability appears in the balance sheet for two loans totaling in the amount of $3,750,000 and accrued interest thereon in the amount of $1,047,813. This loan was granted pursuant to Section 1307 of the New York State Insurance Law. As provided in Section 1307 repayment of principal and interest shall only be made out of free and divisible surplus, subject to the prior approval of the Superintendent of Insurance of the State of New York.

Note 3: Special contingent surplus has been adjusted from $503,090 to $503,726 as discussed in Section G.3 of this report. An offsetting adjustment has been made to Unassigned funds (surplus).

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased $2,629,264 during the five-year examination period, (January 1, 1997, through December 31, 2001) detailed as follows:

STATEMENT OF INCOME

| | | |
|---|---|---|
| Underwriting Income | | |
| Premiums and fees earned | | $7,085,889 |
| Deductions: | | |
| Losses and loss adjustment expenses incurred | $9,608,030 | |
| Underwriting expenses incurred | 423,850 | |
| Total underwriting deductions | | 10,031,880 |
| Net underwriting gain or (loss) | | $(2,945,991) |
| Investment Income | | |
| Net investment income earned | $1,777,200 | |
| Net realized capital gains or (losses) | 183,754 | |
| Net investment gain or (loss) | | 1,960,954 |
| Other Income | | |
| Net gain or (loss) from agents' or premium balances charged off | (175,317) | |
| Finance and service charges not included in premiums | 477,998 | |
| Miscellaneous income | 2,470 | |
| Total other income | | 305,151 |
| Net income or (loss) before federal income taxes | | (679,886) |
| Federal income taxes incurred | | 13,571 |
| Net income or (loss) | | $(693,457) |

CAPITAL AND SURPLUS ACCOUNT

| | | | |
|---|---|---|---|
| Surplus as regards policyholders, December 31, 1996, per report on examination | | | $(895,246) |
| | Gains in Surplus | Losses in Surplus | |
| Net income or (loss) | | $693,457 | |
| Net unrealized capital gains or (losses) | | 32,507 | |
| Change in non-admitted assets | 598,285 | | |
| Change in provision for reinsurance | | 602,800 | |
| Change in excess of statutory reserves over statement reserves | | 7,000 | |
| Change in surplus notes | 3,750,000 | | |
| Cumulative effect of changes in accounting principles | 7,000 | | |
| Aggregate write-in for gains and losses in surplus | | 390,257 | |
| Total gains and losses | $4,355,285 | $1,726,021 | |
| Net increase to surplus as regards policyholders | | | 2,629,264 |
| Surplus as regards policyholders, December 31, 2001, per report on examination | | | $1,734,018 |

## 4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability of $2,585,003 is the same amount reported by the Company as of the examination date. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Company's internal records and in its filed annual statement.

The Company's reserve for unpaid losses and claims are based on individual case estimates for losses on claims reported to the Company as of December 31, 2001, and estimates for unreported losses based upon past experience.

## 5. MARKET CONDUCT ACTIVITIES

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

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

1) Sales and advertising

2) Underwriting

3) Rating

4) Treatment of policyholders and claimants

Except as noted below, no unfair practices were encountered.

### Agent or Broker Terminations

The examiners reviewed the Company's guidelines and procedures for termination of agents and brokers for compliance with Department Regulation 90. As per the Company guidelines, the Underwriting and Marketing Departments perform periodic reviews of agency and broker experience. Upon review, if it's determined that there is cause for terminating an agent or broker's agreement based on low volume and/or loss ratio, the Company would proceed to terminate the agent/broker in accordance with Department Regulation 90.

Based on the Company procedures, it appears that the Company is in violation Section 218.4(a) of Department Regulation 90, with regard to the specific reason for termination.

Section 218.4 of Department Regulation 90 states in part,

"(a) All notices to agents or brokers that their contract or account is to be terminated, in whole or in part, shall state the specific reason or reasons for such termination. A specific reason shall not be an unsupported general statement, such as "insufficient volume" or "poor loss ratio"."

"(b) All such notices shall be mailed or delivered to the affected agent or broker at least 30 days prior to the effective date of such termination..."

It was noted that the termination letters included the redlining notification and gave the 30 day effective notice however, the specific reason was not in accordance with such regulation. When this matter was brought to the Company's attention, it indicated that the procedures would be reviewed and corrective action taken, if deemed necessary. The examiners advised the Company that their guidelines and procedures for termination of agents and brokers should define the criteria for the basis of terminating an agent or broker.

It is recommended that the Company indicate the specific reason for terminating an agent or broker as set forth in Section 218.4 of Department Regulation 90.

It is recommended that the Company institute procedures that adequately define their criteria for low volume and poor loss ratio and apply it consistently to all agents and brokers.

## 6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

A review was made into the actions taken by the Company with regards to the comments and recommendations contained in the prior report on examination. The item letter and page number shown below refers to that of the prior report:

| ITEM | PAGE NO. |
|---|---|
| A. Based upon the results of this examination, the Company was insolvent at December 31, 1996, in the amount of $895,246, and its minimum surplus to be maintained, of $496,336, was impaired in the amount of $1,291,582. Subsequent to the date of this examination on April 1, 1998, the Company received a surplus loan of $3,000,000 from the Eagle Insurance Company, thus eliminating the aforesaid insolvency and impairment. | 1, 17, 27 |
| As noted in the prior report, on April 1, 1998, Eagle Insurance Company purchased a surplus note in the amount of $3,000,000 pursuant to the provisions of Section 1307 of the New York Insurance Law from the Company. Subsequently, on March 12, 1999, Eagle Insurance Company purchased another surplus note from the Company in the amount of $750,000. | |
| B. During the review of the Company's quota share reinsurance treaty, the question arose as to whether an actual transfer of risk to the reinsurers occurs thereunder. A preliminary Department analysis suggests that the 20% loss corridor contained in the contract precludes any meaningful transfer of risk. However, this matter is still undergoing Department evaluation and will be determined at a later date. | 9 |
| The above recommendation is no longer applicable since the Company cancelled the quota share reinsurance treaty as of December 31, 1997 and based on such, the Department deemed further analysis on the transfer of risk redundant. | |
| C. It is recommended that the Company submit its currently effective reinsurance contracts to this Department, and any subsequent amendments thereto, as well as any new contracts it becomes a party to, for Department review, in accordance with Section 1308(e)(1)(A) of the New York Insurance Law. | 9 – 10 |
| The Company has not complied with this recommendation. During the period covered by this examination, the Company failed to file various contracts and subsequent amendments to the reinsurance contracts with the Insurance Department in accordance with Section 1308(e)(1)(A) of the New York Insurance Law. A similar recommendation will be made in this report on examination. | |

D. It does not appear to be reasonable to spend money belonging to all of the policyholders in order to send out proxy statements, which also include notice of the annual meeting, to only a few of the Company's policyholders. It is recommended that all policyholders be treated equally in this matter. 13

The Company has complied with this recommendation.

E. It is recommended that the Company comply with Section 6609(a)(2) of the New York Insurance Law by including the required by-law provisions in the proper place in all policies issued in the future. 13 – 14

The Company has complied with this recommendation.

F. Management is directed to establish and maintain written documentation supporting the percentages used to allocate expenses to the major expense groups, as required by Department Regulation 30. 14 – 15

The Company has not complied with this recommendation. The Company has indicated that they are aware of the provisions of Department Regulation 30 and plans to perform a Regulation 30 study in Year 2003. The Company has taken the position that performing a Regulation 30 study at this point would be meaningless since they are in the process of separating their operation from the Robert Plan Corporation.

G. It is recommended that, henceforth, the Company follow the NAIC guidelines for obtaining values of securities not listed in the NAIC's "Valuation of Securities" manual. 15

The Company has complied with this recommendation.

H. It is recommended that all of the Company's investments be approved in accordance with Section 1411(a) of the New York Insurance Law, henceforth. 15 – 16

The Company has complied with this recommendation.

I. It is recommended that if the Company enters into any repurchase agreements in the future, that it ensure that such investments are structured so as to allow compliance with Section 1411(b) of the New York Insurance Law and that it report such investments in accordance with the annual statement instructions, in financial statements to this Department. 20 – 21

The Company has complied with this recommendation.

J. The Company should determine its over 90 days past due premiums in accordance with the Department's unnumbered circular letter dated November 29, 1978, henceforth. 22

The Company has not complied with this recommendation. Subsequent to the prior examination date, the Department's unnumbered circular letter dated November 29, 1978 was withdrawn. Effective January 1, 2001, the Insurance Department adopted the NAIC Accounting Practices and Procedures Manual. Based on such, it appears that the Company is not in compliance with the guidelines pursuant to SSAP No. 6 of the NAIC Accounting Practices and Procedures Manual for determining premiums over 90 days past due.

K. The Company should report agents' balances or uncollected premiums net of commissions' payable thereon, as required by the annual statement instructions. 22

The Company has complied with this recommendation.

L. The Company should report "Advance Premiums" in accordance with the annual statement instructions, in future financial statements filed with this Department. 22

The Company has complied with this recommendation.

M. The Company should base agents' balances or uncollected premiums on only written premiums and not a combination of written and billed premiums. 22

The Company has complied with this recommendation.

N. It is recommended that the Company increase its carried loss and loss adjustment expense reserves by the amount of the deficiency noted in this report, and reflect such reserve strengthening in future financial statements filed with this Department. 23

The Company has complied with this recommendation.

O. It is recommended that, in all future financial statements filed with this Department, the Company report the proper amount of its required surplus in accordance with Section 4109 of the New York Insurance Law. 25 – 26

The Company has complied with this recommendation.

P. It is recommended that when sending out notices of termination of agents' or brokers' contracts or accounts, the Company ensure that the requirements of Sections 218.4 and 218.5 of Department Regulation 90 are complied with, henceforth. 27

The Company has not complied with this recommendation. The termination letters included the redlining notification and gave the 30 day effective notice however, the specific reason was not in accordance with such regulation. A similar recommendation will be made in this report on examination.

## 7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

D. Accounts and Records

i. It is recommended that the Company amends its corporate resolutions with the Trustco Bank accurately reflect the current officers authorized to act on the Company's behalf. 17

ii. It is recommended that the Company comply with the provisions of Section 1307(c) of the Insurance Law, with respect to the loan and the accrued interest being disclosed as part of the standard footnote. 18

iii. It is also recommended that the Company adhere to the terms of the surplus note agreements when calculating accrued interest on the outstanding principal amount. 18

iv. It is recommended that the Company calculate and accumulate the special contingent surplus pursuant to the provisions of Section 4109(b) of the New York Insurance Law. 19

v. It is recommended that the Company adjust its books and records to reflect the special contingent surplus in the amount of $503,726 as determined by this examination. 19

vi. It is recommended that the Company comply with the guidelines pursuant to SSAP No. 6 of the NAIC Accounting Practices and Procedures Manual for determining premiums over 90 days past due. 20

vii. It is recommended that the Company adhere to the provisions of Department Regulation 30 regarding the allocation of expenses between insurance companies and to the major expense groups. 20

viii. It is recommended that the Company keep in clear and legible form, records of all bases of allocation. Such records should fully disclose the bases and be readily available for examination. 20

E. Market Conduct Activities

i. It is recommended that the Company indicate the specific reason for terminating an agent or broker as set forth in Section 218.4 of Department Regulation 90. 25

ii. It is recommended that the Company institute procedures that adequately define their criteria for low volume and poor loss ratio and apply it consistently to all agents and brokers 25

Respectfully submitted,

/S/

Jimmie Newsome
Senior Insurance Examiner

STATE OF NEW JERSEY)
) SS.
)
MORRIS COUNTY )

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

/S/

Jimmie Newsome

Subscribed and sworn to before me
this 13 day of August 2003.

PATRICIA J. HAAG
NOTARY PUBLIC OF NEW JERSEY
My Commission Expires June 6, 2007

*Appointment No.* 21838

*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:*

**Jimmie Newsome**

*as proper person to examine into the affairs of the*

**COMMERCIAL MUTUAL 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* 21st *day of* February, 2002

*GREGORY V. SERIO*
*Superintendent of Insurance*