

REPORT ON EXAMINATION

OF THE

FIRST COMMUNITY INSURANCE COMPANY

AS OF

DECEMBER 31, 1999

DATE OF REPORT

SEPTEMBER 5, 2000

EXAMINER

GLENDA M. GALLARDO

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

September 5, 2000

Honorable Neil D. Levin
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 Number 21532 dated May 2, 2000, attached hereto, I have made an examination in to the condition and affairs of the First Community Insurance Company as of December 31, 1999, and submit the following report thereon.

The examination was conducted at the Company's administrative offices located at 360 Central Avenue, St. Petersburg, Florida.

Wherever the designations "the Company" or "FCIC" appear herein without qualification, they should be understood to indicate the First Community Insurance Company. In addition, wherever the designations "BIG" or "parent company" appear herein without qualification, they should be understood to indicate Bankers Insurance Group, Inc.

Whenever the designation “the Department” appears herein without qualification, it should be understood to mean New York Insurance Department.

1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1993. This examination covered the six year period from January 1, 1994 through December 31, 1999, and it 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 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 Company
- Management and control
- Corporate records
- Fidelity bond and other insurance
- Territory and plan of operation
- Market conduct activities
- Growth of Company
- Business in force by states
- Reinsurance
- 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 included 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 THE COMPANY

The Company was originally incorporated as Soflens Insurance Company on June 7, 1971, under the laws of the State of New York. As of January 1, 1980, the name was changed to Bausch & Lomb Insurance Company and on January 1, 1993, the present name of First Community Insurance Company was adopted. Effective October 1, 1993, Bankers Insurance Group, Inc. of St. Petersburg, Florida acquired all issued and outstanding shares of the Company's stock from Bausch & Lomb, Inc., the owner of the Company since its inception.

As of December 31, 1993, the Company's paid in capital was \$3,150,000, consisting of 7,875 shares of common stock with a par value of \$400 per share. On January 1, 1994, the Company reduced the par value of its common stock from \$400 to \$318 per share, resulting in a reduction of the paid in capital from \$3,150,000 to \$2,504,250. In 1994 and 1996, the Company's board of directors approved the issuance and sale of an additional 1,573 and 1,450 shares, respectively, of its common stock to Bankers Life Insurance Company, an affiliated insurer domiciled in Florida. As a result of both sales, FCIC's paid-in capital increased from \$2,504,250 consisting of 7,875 shares of common stock to \$3,465,564 consisting of 10,898 shares of common stock. On November 30, 1999, Bankers Life Insurance Company sold all 3,023 shares of FCIC's common stock back to the parent company, Bankers Insurance Group, Inc.

A. Management

Pursuant to the Company's charter and by-laws, management is vested in a board of directors consisting of not less than 13 members nor more than 15 members. As of the examination date, the board of directors was comprised of thirteen members. The board met at least four times during each calendar year. The directors as of December 31, 1999 were as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Richard Castor Chadds Worth, PA	Retired
G. Kristin Delano St. Petersburg, FL	Secretary & General Counsel, First Community Insurance Co.
Joseph M. DeRoche Cortlandt Manor, NY	Account Executive, Martin Insurance Agency
Gary R Froid St. Petersburg, FL	District & Special Agent, Northwestern Mutual Life
Bill Gunter Tallahassee, FL	Chief Executive Officer, Rogers, Atkins, Gunter & Associates Insurance Inc.
Edwin C. Hussemann St. Pete Beach, FL	Treasurer, First Community Insurance Company
Robert M. Menke Tierra Verde, FL	Chairman of the Board of Directors, Bankers Insurance Group, Inc.
Robert G. Menke St. Petersburg, FL	President, First Community Insurance Company
David K. Meehan St. Petersburg, FL	Vice Chairman, First Community Insurance Company
J. Wayne Mixson Tallahassee, FL	Retired

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
David B. Nye Gainesville, FL	Professor, University of Florida
Douglas, B. Pierce Plano, TX	President, Bankers Life Insurance Company
Robert E. Pachner Hastings-on-Hudson, NY	Director of Information Technology, Kaye Insurance Associates

The minutes of all meetings of the board of directors and committees thereof held during the examination period were reviewed. The review of the minutes disclosed that the meetings were well attended with the exception of Robert E. Pachner and Joseph M. DeRoche, each of whom attended less than 50% of the meetings for which 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 the board may reach appropriate decisions. 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.

As a further note to this issue, the Company is hereby reminded of its commitment letter issued to the Department at the time of its acquisition by BIG, where it agreed to conduct business according to the Department's Criteria and Guidelines for Domestic Property/Casualty Companies. The purpose of the commitment was to ensure that the Company would maintain operations in New York with officers and directors having decision-making powers, who would

also be directly involved in the operations and affairs of the Company. The Company is not fully adhering to or fulfilling its commitment made to this Department if such officers do not attend board meetings on a regular basis.

It is recommended that the Company adhere to its commitment made to this Department.

In addition to the poor attendance of the two New York directors, the Company appears to be in violation of Section 1201(a)(5)(B)(vi) of the New York Insurance Law, which reads as follows:

...“the times and manner of electing directors and officers, the manner of filling vacancies, and provision that each director shall be at least eighteen years of age and that at all times a majority shall be citizens and residents of the United States, and that not less than three shall be residents of this state;”

As of the examination date, there were only two directors that were residents of New York State. It is recommended that the Company comply with Section 1201(a)(5)(B)(vi) of the New York Insurance Law by increasing the number of directors residing in New York to a minimum of three.

As of December 31, 1999, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Robert G. Menke	President
Edwin C. Hussemann	Treasurer
G. Kristin Delano	Secretary
Ann R. Worthington	Senior Vice President
Paul DiFrancesco	Senior Vice President
Stephen A. Murray	Senior Vice President

The Company has established a policy for disclosure to its board of directors or trustees of any material interest or affiliation on the part of its officers, directors, trustees or responsible employees which is likely to conflict with the official duties of such person. The disclosures are made through the use of conflict of interest statements distributed to each director and officer of the Company. The Company indicated however, that these statements are not always signed annually. It is therefore recommended that the Company make certain that conflict of interest statements be distributed and signed by all officers and directors of the Company on an annual basis.

B. Territory and Plan of Operation

As of December 31, 1999 the Company was licensed to transact business in all fifty states. It 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:

<u>Paragraph</u>	<u>Kind of Insurance</u>
3	Accident and health
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
16	Fidelity and surety
17	Credit
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity
24	Credit unemployment
26(A)(B)(C)(D)	Gap insurance
30	Substantially similar kinds of insurance

Prior to the Company's acquisition by BIG, the Company's book of business consisted only of a program called Lensurance. This program provides insurance for purchasers of contact lenses against damage or loss of the lenses. Currently, FCIC's writings include insurance of contract surety bonds, bail bonds, special commercial products, and non-standard private passenger automobile liability. Further, the Company is a participant of the National Flood Insurance Program that provides a significant amount of non-risk bearing premiums and ceding commission income.

Bankers Underwriters Inc., an affiliated company, assists FCIC with the marketing of its products. Business is produced through the use of hundreds of independent agencies located throughout the United States.

The volume of direct premiums written in New York during the examination period as a percentage to total premiums written is as follows:

DIRECT PREMIUMS WRITTEN

<u>Calendar Year</u>	<u>New York State</u>	<u>Total United States</u>	<u>Percentage of U.S. Premiums Written in New York State</u>
1994	\$ 220,349	\$ 2,047,447	10.76%
1995	\$ 414,207	\$ 4,451,779	9.30%
1996	\$ 727,831	\$ 8,857,595	8.21%
1997	\$1,297,222	\$15,336,455	8.45%
1998	\$1,646,356	\$28,391,148	5.79%
1999	\$2,098,530	\$35,526,697	5.90%

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 in the amount of \$4,450,000.

C. Reinsurance.

The Company has no assumed reinsurance.

The Company participates in the Florida Hurricane Catastrophe Fund administered by the State Board of Administration of the State of Florida ("SBA"). As a participant, the SBA reimburses the Company for losses caused by any storm declared to be a hurricane by the National Hurricane Center.

Since 1994, the Company has been a servicing carrier for the National Flood Insurance Program under the "Write Your Own" program. Business written under this program is 100% ceded to the US Government. In exchange for the services provided under the program, the Company receives a ceding commission fee based on losses incurred related to the flood business only.

The Schedule F data as contained in the Company's annual statements filed for the years within the examination period was found to accurately reflect its reinsurance transactions.

The examiner reviewed all ceded reinsurance contracts effected during the examination period. The review indicated that all contracts contained an insolvency clause; however, certain

agreements contained an insolvency clause that did not meet the standard wording required by Section 1308 of the New York Insurance Law.

It is recommended that the Company amend all reinsurance agreements in which the insolvency clause does not meet the requirements of Section 1308 of the New York Insurance Law. Further, it is recommended that the Company make certain that in the future its reinsurance agreements contain the required insolvency clause wording before such agreements become effective.

As of the date of the examination, the Company had the following ceded reinsurance program in effect:

<u>Treaty</u>	<u>Cession</u>
<u>First Excess of Loss Reinsurance Agreement</u>	
100% Authorized	
Property	\$750,000 excess of \$250,000, per risk to a maximum of \$1,500,000, per loss occurrence.
Casualty	\$750,000 excess of \$250,000, per occurrence. \$750,000 excess of \$250,000, per each combination loss.
Second Casualty Excess of Loss	\$2,000,000 excess of \$1,000,000, each occurrence.
<u>80% Non-Standard Private Automobile Quota Share Reinsurance Contract</u>	
90% Authorized	100% participation of 80% of the Company's net liability on business produced by Sun Coast General Insurance Agency (California).
10% Unauthorized	

80% Quota-Share Multiple Line Property and
Casualty reinsurance agreement

100% Authorized

Property

100% participation of \$1,200,000, per risk in excess of \$300,000.

Casualty

100% participation of \$800,000, per risk in excess of \$200,000; \$1,600,00 in the aggregate.

Liquor liability

100% participation of \$800,000, per risk in excess of \$200,000; \$1,600,00 in the aggregate.

Contract provides coverage only for business written under the Harbor Premier Products Inc.-Restaurant Program and insureds domiciled in the state of Florida.

Excess of Loss Reinsurance Agreement
covering surety contracts, but excluding bail
bond business

100% Authorized

90% of \$3,850,000 in excess of \$150,000 not to exceed an all time aggregate of \$7,500,000.

50% Multiple-Line Quota Share

100% Authorized

Property

50% of \$1,000,000, each risk.

Casualty

50% of \$300,000, each occurrence to a maximum of 50% of \$39,000,000, per loss occurrence.

Contract covers property located in the state of Florida only.

Property Catastrophe Excess of Loss

100% Authorized

100% of the excess over \$2,000,000 to a maximum of \$22,000,000, per loss occurrence and a maximum of \$44,000,00 per contract term.

Catastrophe Excess of loss

100% Authorized

Excess flood only

97.5% of \$5,000,000, in excess of \$1,000,000 not to exceed a maximum of 97.5% of \$10,000,000, per contract term.

Workers' Compensation OccupationalAccident Excess of Loss

100% Authorized

First layer

\$4,750,000 each and every loss occurrence in excess of \$250,000.

Second layer

\$20,000,000 each and every loss occurrence in excess of \$5,000,000, not to exceed \$60,000,000 in the aggregate.

80% Workers' Compensation Quota ShareReinsurance Agreement

100% Authorized

Only for business produced by MJK Insurance Agency, Inc.

80% of \$250,000, each and every loss occurrence.

80% Occupational Accident Quota Share &Excess of Loss Reinsurance Agreement

100% Authorized

80% Occupational Accident Quota Share

80% of \$250,000, each and every loss occurrence.

Excess of Loss Layer Occupational Accident

100% Authorized

100% of \$750,000, each and every loss occurrence in excess of \$250,000.

Only for business produced by MJK Insurance Agency, Inc.

The reinsurance program described above was implemented due to the change in insurance coverages marketed by the Company since the previous examination period. Since 1995 to the present, the Company has expanded its operations into new lines of business that include contract surety bonds, bail bonds, personal lines and non-standard auto coverage. Consequently, this new exposure created the need to obtain reinsurance protection.

The review of the reinsurance program also disclosed that most of the contracts reinsure both FCIC and its affiliate, Bankers Insurance Company. It was noted that some of these contracts contain deposit premiums and aggregate limits/retention provisions that apply to the entire contract; however, the Company did not have any documentation indicating how these deposit premiums or aggregate limits/retention provisions would be allocated or shared between the two ceding companies.

It is recommended that the Company formalize, in writing, procedures detailing how the reinsurance contract provisions will be applied to the ceding participants. Such agreement should comply with Section 1505(a) of the New York Insurance Law, which provides as follows:

“Transactions within a holding company system to which a controlled insurer is a party shall be subject to the following:

- (1) the terms shall be fair and equitable;
- (2) Charges or fees for services performed shall be reasonable; and
- (3) Expenses incurred and payments received shall be allocated to the insurer on an equitable basis...”

Once signed, this agreement should be submitted to the Department for review pursuant to Section 1505(d) of the New York Insurance Law.

As of the examination date the Company had in effect a 50% Quota Share reinsurance agreement with Western International Insurance Company (“WIIC”), an unauthorized reinsurer domiciled in the Cayman Islands. The agreement contains all standard clauses including the insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law. Several amendments individually signed by each participating agent or agency are attached to, and form part of, the agreement. The amendments relative to the multi-peril and dwelling fire risks had an effective/inception date of November 11, 1999. It was noticed, however, that the Company’s ceding statements reflected premiums and losses ceded to the reinsurer prior to the effective date of the agreement. Because the premium balances ceded and losses recovered were immaterial to the Company’s financial position, no changes were made to the financial statements contained herein. However, it is recommended that the Company properly account for its reinsurance transactions. The following table exhibits the reinsurance program provided by WIIC.

Treaty50% Quota ShareHome Owner Multi-Peril and Dwelling Fire

Property

Cession

\$250,000 each risk subject to a maximum of \$1,500,000, any one loss occurrence.

Casualty

\$250,000 each occurrence.
\$250,000 each property & casualty combination loss.

Coverage applies only to business produced by certain agents.

Surety

100% Unauthorized

Bail bond (excluding business produced by Marcotte National Inc.)

50% of the Company's net liability after meeting the Company's retention of \$500,000, each principal not to exceed \$250,000, each principal.

Bail bond business produced by Marcotte National Inc.

50% of the Company's net liability after meeting the Company's retention of \$500,000, each principal not to exceed the reinsurer's limit liability of \$250,000, each principal and subject to an all time aggregate limit of liability of \$1,500,000.

Stop loss cover note

50% of the Company's net retention of its net liability not to exceed the reinsurer's limit liability of \$250,000, each principal and subject to an all time aggregate limit of liability of \$1,500,000.

Coverage only applies to bail bond business produced by Marcotte National Inc.

D. Holding Company System.

First Community Insurance Company is a wholly-owned subsidiary of Bankers Insurance Group, Inc., which is owned by Bankers Financial Corporation. Mr. Robert M. Menke, Chairman of the Bankers Insurance Group, Inc. and all subsidiaries has been deemed to be the Company's ultimate controlling person. As such, the Company is a controlled insurer registered pursuant to Section 1503 of the New York Insurance Law.

The following organizational chart details all companies within the holding company system:

The Company is party to several agreements with members of its holding company group as follows:

1. Service Agreement with Bankers Insurance Group, Inc.

On September 1, 1993, FCIC executed a service agreement with its parent company, Bankers Insurance Group, Inc. (“BIG”). Pursuant to the terms of this agreement, BIG provides FCIC with all administrative services needed to carry out its day to day business operations. In addition to the administrative services, BIG agreed to provide FCIC with property, equipment, and facilities as FCIC may request. In 1998, this agreement was partially replaced by a new agreement effected with Insurance Management Solution (“IMS”), an affiliated company described in Item 3 of this Section. However, the parent company continued to perform certain functions for FCIC such as investment, legal, auditing services, etc.

In October 1999, the Company submitted to the Department a Bail and Surety Administration Addendum to this agreement to become effective on January 1, 2000. The purpose of this addendum was to add bail surety administration and marketing to the services performed under the agreement with BIG. However, the services would be conducted by Bankers Surety Services (“BSS”), one of the Company’s affiliates. Also, the agreement also stated that FCIC should receive from BSS, 4.65% of all collected net written premiums. The excess is retained by BSS to pay bail bondsmen commissions, premium taxes and all costs and expenses incurred in administering the program.

Both the agreement and the addendum were submitted to, and non-disapproved by the Department, pursuant to Section 1505(d)(3) of the New York Insurance Law.

The examiner conducted a review of the accounting activity of the bail bond program and the flow of transactions between BSS and the Company that occurred during the first quarter of 2000. The review disclosed that the accounting staff involved in the bail bond processing did not appear to be aware of the existence of the addendum and its provisions. This may be viewed as an internal control deficiency due to the failure of the Company to communicate to its staff information directly affecting the processing of transactions that might result in accounting errors.

It is recommended that the Company establish procedures for communicating and disseminating to its staff all relevant information that may affect the accounting of the Company's transactions and the reporting of its financial statements.

It was also noted that at the time of this review, balances due the Company for the 1st and 2nd quarter of 2000 have not been settled.

It is recommended that the Company make certain that in the future its receivable balances be settled promptly.

The examination review of expenses related to the services agreement found that the Company's cost sharing documentation was lacking. It is recommended that the Company maintain adequate records available for statutory review to support the cost sharing of expenses, in accordance with Department Regulation 30.

2. Management Agreement

The Company is a party to a management agreement between BIG and all companies owned and controlled by BIG. Pursuant to the terms of the agreement, which was effective January 1, 1994, all companies appointed BIG to serve as their manager and perform all necessary administrative and executive functions pertaining to the operations of each company's business. A schedule listing of agreed upon estimated monthly fees is attached to the agreement. This contract is issued and signed annually by the participating parties.

This agreement was never submitted to the Department for review and non-disapproval as required by Section 1505(d)(3) of the New York Insurance Law.

During the examination, the Company was not able to explain how the management agreement in effect since 1994 and the service agreement in effect since 1993 differ. Subsequent to the examination, the Company management consulted with its accounting department and found that the management agreement was not applicable to the Company, but only to other BIG affiliates. The use of the management agreement as pertains to the Company was in error. As such, only the 1993 service agreement was in effect during the intervening period and the Company had only been billed for services pursuant to the services agreement. Thus, the Company's management agreement with BIG was to be voided and canceled.

3. Service Agreement with Insurance Management Solutions

Effective January 1, 1998, the Company entered into a service agreement with Insurance Management Solutions, ("IMS") a Florida affiliate. Pursuant to the terms of the agreement, IMS

performs certain administrative and special services such as claims processing, functional support services and customer service for FCIC. IMS also makes available property, data processing and communication equipment, and facilities as FCIC may request. In exchange for providing these services and facilities, the Company reimburses IMS pursuant to a service fee schedule. Service fees payable for claim services are based on a percentage of earned premiums and service fees for policy issuance are based on a percentage of written premiums.

This agreement was submitted to and non-disapproved by the Department as required by Section 1505(d)(3) of the New York Insurance Law. However, it is recommended that the Company amend this agreement so that claim service fees are calculated as a percentage of claims rather than earned premiums. Such amendment should be filed with the Department pursuant to Section 1505(d) of the New York Law.

The examination review of the transactions and documentation related to the service fees charged to FCIC under the agreement described above disclosed the following:

- i. Effective January 1, 1999, Exhibit A of the IMS service agreement was revised. Effective April 1, 1999, a second addendum was executed, which provided for FCIC and its affiliates to pay IMS an aggregate minimum service fee of \$10,942,000 for the nine-month period April 1, 1999 to December 31, 1999. It is noted that service arrangements based on minimum fees do not meet the cost allocation requirements of Regulation 30. Further, none of these addenda were submitted to the Department for review and non-disapproval prior to their implementation. Therefore, it appears that the Company was in violation of Section 1505(d)(3) of the New York Insurance Law.

ii. A review of the fees charged to FCIC pursuant to the second addendum for the period of April 1, 1999 to June 30, 1999 disclosed that the Company made an additional payment to IMS in the amount of approximately \$306,000. The payment was made to cover the minimum service fee due IMS for such period. It was noted that the additional charge was based on the negative variance resulting from the difference between projected written premiums and actual premiums. This examination considers that the payment was not reasonable since it seems that FCIC was charged for services that were not actually rendered given the basis of the charge. This would constitute a violation of Section 1505(a) which reads in part as follows:

“Transactions within a holding company system to which a controlled insurer is a party shall be subject to the following:

- (1) the terms shall be fair and equitable;
- (2) charges or fees for services performed shall be reasonable;...”

Therefore, it is recommended that the Company comply with Section 1505(a) of the New York Insurance Law. It is further recommended that the Company be reimbursed by IMS for the amounts related to such additional payment.

Both the BIG and IMS Service Agreements contain provisions that require the servicing companies to submit, within thirty days after the close of each month, a detailed written statement and accounting of the charges for services rendered to FCIC and its use of the facilities. The Company was unable to provide any account reconciliations with respect to the services provided by BIG. Furthermore, it was noted that certain accounting records supporting transactions between the affiliates were not adequately documented.

It is recommended that the Company comply with the terms of its service agreements by requiring BIG and IMS to submit monthly written statements detailing services rendered and the related charges. It is also recommended that the Company maintain better supporting documentation of the transactions between affiliates.

It is further recommended that the Company conduct a cost study to ensure that the service fees and management fees charged by IMS under the service agreements are in conformity with the cost allocation requirements of Department Regulation 30.

4. Technical Support Service Agreement

On April 1, 1999, a Technical Support Service Agreement between Insurance Management Solutions, Inc. and Bankers Insurance Group, Inc. and its subsidiaries was executed. The purpose of the agreement was to establish an ongoing technical arrangement between IMS and the BIG's entities. IMS agreed to provide technical support services relating to computer programming, system analysis and related services that included writing and designing new programs, maintaining existing programs, providing technical advice on systems either built or maintained for the entities.

This agreement was never submitted to the Department as required by Section 1505(d)(3) of the New York Insurance Law. It is recommended that the Company immediately submit this agreement to the Department pursuant to the requirements of Section 1505(d)(3) of the New York Insurance Law.

5. Tax Allocation Agreement

Concurrent with the acquisition of the Company by BIG, the Company became a party to a tax allocation agreement between Bankers Financial Corporation and several of its subsidiaries. The agreement was submitted to and approved by this Department.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 1999, and based upon the results of this examination:

Net premiums written to Surplus as regards policyholders	1.12 to 1
Liabilities to liquid assets (cash and invested assets less investment in affiliates)	63.21%
Premiums in course of collection to Surplus as regards policyholders	22.48%

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

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

	<u>Amounts</u>	<u>Ratios</u>
Losses incurred	\$10,156,851	33.39%
Loss adjustment expenses incurred	3,851,880	12.66%
Other underwriting expenses incurred	16,319,437	53.65%
Net underwriting gain	<u>90,686</u>	<u>0.30%</u>
Premiums earned	<u>\$30,418,854</u>	<u>100.00%</u>

F. Abandoned Property Law

During the examination period, the Company filed abandoned property reports as required by Section 1316 of the New York State Abandoned Property Law.

G. Accounts and Records

Agency Agreements

The Company distributes its insurance products through the use of several contracted general agents located throughout the United States. The review of the agent/agency agreements provided during the course of this examination disclosed that the provision relating to the governing law of the contracts indicate that the contracts would be subject to the laws of Florida rather than New York. It is recommended that all new and renewal agency agreements indicate that the governing law of such contracts is New York.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities, and surplus as regards policyholders as determined by this examination. This statement is the same as the balance sheet filed by the Company:

<u>Assets</u>	<u>Ledger Assets</u>	<u>Non-Ledger Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$13,089,160			\$13,089,160
Cash and short term investments	3,696,273			3,696,273
Premiums and agents' balanced in course of collection (after deducting ceded balances of \$732,454)	1,354,110		\$25,777	1,328,333
Premiums and agents' balances booked and deferred but not yet due (after deducting ceded balances of of \$11,539)	20,917			20,917
Reinsurance recoverable on loss and loss adjustment expense payments	1,195,127			1,195,127
Federal income tax recoverable	38,788			38,788
Electronic data processing equipment	2,201			2,201
Interest, dividends and real estate income due and accrued		\$189,118		189,118
Receivable from parent, subsidiaries and affiliates	22,413			22,413
Other assets non-admitted	13,329		13,329	
Accounts receivable – other	1,163		1,163	
Prepaid expenses	11,230		11,230	
NFIP Growth Bonus	<u>310,659</u>			<u>310,659</u>
Total assets	<u>\$19,755,370</u>	<u>\$189,118</u>	<u>\$51,499</u>	<u>\$19,892,989</u>

Liabilities

Losses	\$3,126,157
Loss adjustment expenses	340,697
Contingent commission	20,000
Other expenses	433,775
Taxes, licenses & fees	373,159
Unearned premiums	4,193,286
Dividends declared and unpaid to policyholders	41,087
Amounts withheld or retained by company for account of others	1,898,531
Provision for reinsurance	37,378
Excess of statutory reserves over statement reserves	138,000
Payable for securities	127,273
	<hr/>
Total liabilities	10,729,343
	<hr/>

Surplus

Common capital stock	3,465,564
Gross paid in and contributed surplus	1,884,436
Unassigned surplus	3,813,645
	<hr/>
Surplus as regards policyholders	9,163,645
	<hr/>
Total liabilities and surplus	<u>\$19,892,988</u>

Note: The Internal Revenue Service completed its audits of the consolidated income tax returns filed on behalf of the Company for the years 1992-1994. Field work on audits covering tax years 1995-1996 has been completed although the final report has yet to be issued. Any material adjustments, if any, made subsequent to the date of this examination and arising from said audits, are reflected in the financial statements included in this report. Audits covering tax years 1997-1999 are yet to commence. Except for the impact which might result from a proposed adjustment made by the IRS for the 1995-1996 audit, 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.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$4,147,744 during the six-year examination period from January 1, 1994 through December 31, 1999 detailed as follows:

Underwriting Income

Premiums earned:		\$30,418,854
Deductions		
Losses incurred	\$10,156,851	
Loss adjustment expenses incurred	3,851,880	
Other underwriting expenses incurred	<u>16,319,437</u>	
Total underwriting deductions		<u>30,328,168</u>
Net underwriting gain		\$90,686

Investment Income

Net investment income earned	\$3,731,034	
Net realized capital gain	<u>79,033</u>	
Net investment gain		3,810,067

Other Income

Net loss from agents' balances charged off	\$(6,888)	
Miscellaneous loss	\$(12,623)	
Finance and service charges	<u>200,953</u>	
Total other income		<u>181,442</u>
Net income before dividends to policyholders and federal and foreign income taxes		\$4,082,195
Dividends to policyholders		<u>368,950</u>
Net Income after dividends to policyholders but before federal and foreign income taxes		\$4,082,195
Federal & foreign income taxes incurred		<u>1,579,742</u>
Net income		<u>\$2,133,503</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 1993, per report on examination			\$5,015,901
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$2,133,503		
Change in non-admitted assets		\$16,961	
Change in liability for reinsurance		37,378	
Change in excess of statutory over statement reserves		138,000	
Capital paid in	500,214		
Surplus paid in	1,699,786		
Miscellaneous gain	6,580		
Total gains and losses	<u>\$4,340,083</u>	<u>\$192,339</u>	
Net increase in surplus as regards policyholders			<u>\$4,147,744</u>
Surplus as regards policyholders, December 31, 1999 per report on examination			<u>\$9,163,645</u>

4. LOSSES & LOSS ADJUSTMENT EXPENSES

The examination liabilities for losses and loss adjustment expenses of \$3,126,157 and \$340,697 respectively are the same as the amounts reported by the Company as of December 31, 1999. In 1995, the Company began diversifying its book of business. Because of the lack of historical loss data the reserve estimates recorded by the Company were based on Bankers Insurance Company's loss development factors. Bankers Insurance Company, ("BIC"), is one of the Company's affiliates and a property and casualty insurer domiciled in Florida.

It is recommended that the Company closely monitor the development of its loss reserves due to the shifting of its product lines and the lack of credible historical data of its underlying programs.

The examination review of the reconciliation between the Company's underlying loss data and Schedule P disclosed that certain differences between the two were never reconciled by the Company. It is recommended the Company make certain that its underlying loss data reconcile to the data reported in Schedule P of its filed annual statements.

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

more precise scope of a market conduct investigation, which is the responsibility of the market conduct unit of the Property Bureau of this Department.

The review was directed only at the practices of the Company in the claim processing and advertising areas. No significant problem areas were encountered.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report contained four comments and recommendations as follows (page numbers refer to the prior report):

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Conflict of Interest Statements</u>	13
<p>It is recommended that the Company obtain conflict of interest statements from its board members and principal officers.</p> <p>The Company did not comply with this recommendation.</p>	
B. <u>Bonds-Minimum Surplus Investments</u>	18
<p>It is recommended that the Company restructure its bond portfolio to contain the types of bonds in the requisite amounts so that it is in compliance with Section 1402 of the New York Insurance Law that governs minimum surplus investments. This will also assure that the Company is in compliance with the commitment of the parent to restrict the Company's mortgage investments.</p> <p>The Company complied with this recommendation.</p>	
C. <u>Premiums in Course of Collection</u>	19
<p>It is recommended that the Company eliminate non-premium items from its premiums receivable account.</p> <p>The Company complied with this recommendation.</p>	

D. Deductible Recoverable from Policyholders 20

It is recommended that the Company properly classify all deductibles and disallow any items that fail to meet the customary criteria of admissible assets.

The Company complied with this recommendation.

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
i. It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.	5
ii. It is recommended that the Company adhere to its commitment made to this Department.	6
iii. It is recommended that the Company comply with Section 1201(a)(5)(B)(vi) of the New York Insurance Law by increasing the number of directors residing in New York to a minimum of three.	6
iv. It is recommended that the Company make certain that conflict of interest statements be distributed and signed by all officers and directors of the Company on an annual basis.	7
B. <u>Reinsurance</u>	
i. It is recommended that the Company amend all reinsurance agreements in which the insolvency clause does not meet the requirements of Section 1308 of the New York Insurance Law. Further, it is recommended that the Company make certain that in the future its reinsurance agreements contain the required insolvency clause wording before such agreements become effective.	10
ii. It is recommended that the Company formalize, in writing, procedures detailing how the reinsurance contract provisions will be applied to the ceding participants in accordance with Section 1505(a). Such contract should be submitted to the Department for review pursuant to Section 1505(d) of the New York Insurance Law.	13

<u>ITEM</u>	<u>PAGE NO.</u>
iii. It is recommended that the Company properly account for its reinsurance transactions.	14
<u>C. Holding Company System</u>	
i. It is recommended that the Company establish procedures for communicating and disseminating to its staff all relevant information that may affect the accounting of the Company's transactions and reporting of its financial statements.	19
ii. It is recommended that the Company make certain that in the future its receivable balance be settled promptly.	19
iii. It is recommended that the Company amend the service agreement with IMS so that claim service fees are calculated as a percentage of claims rather than earned premiums.	21
iv. It is recommended that the Company comply with Section 1505(a) of the New York Insurance Law. It is further recommended that the Company be reimbursed by IMS for the amounts related to such additional payment.	22
v. It is recommended that the Company comply with the terms of its service agreements by requiring BIG and IMS to submit monthly written statements detailing services rendered and the related charges. It is also recommended that the Company maintain better supporting documentation of the transactions between affiliates.	22
vi. It is further recommended that the Company conduct a cost study for the period January 1, 1998 to the present, to ensure that the service fees and management fees charged by both BIG and IMS under the service agreements were in conformity with the cost allocation requirements of Department Regulation 30.	23
vii. It is recommended that the Company immediately submit the technical support service agreement to the Department pursuant to the requirements of Section 1505(d) of the New York Insurance Law.	23
<u>D. Accounts and Records</u>	
i. It is recommended that all new and renewal agency agreements indicate that the governing law of such contracts is New York.	25

ITEMPAGE NO.E. Losses and Loss Adjustment Expenses

- | | |
|---|----|
| i. It is recommended that the Company closely monitor the development of its loss reserves due to the shifting of its product lines and the lack of credible historical data of its underlying programs. | 30 |
| ii. The examination review of the reconciliation between the Company's underlying loss data and Schedule P disclosed that certain differences between the two were never reconciled. It is recommended that the Company make certain that its underlying loss data reconciles to Schedule P of its filed annual statements. | 30 |

Respectfully submitted,

/S/

Glenda Gallardo
Senior Insurance Examiner

STATE OF NEW YORK)
) SS.
)
COUNTY OF NEW YORK)

GLEND GALLARDO, being duly sworn, deposes and says that the foregoing report submitted by her is true to the best of her knowledge and belief.

/S/

Glenda Gallardo

Subscribed and sworn to before me
this _____ day of _____ 2001.

Appointment No 21532

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, NEIL D. LEVIN, Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:

Glenda Gallardo

as proper person to examine into the affairs of the

First Community Insurance Company

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

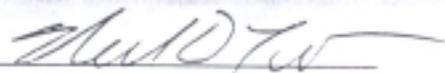
Company

with such other information as she 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 2nd day of May 2000




NEIL D. LEVIN
Superintendent of Insurance