REPORT ON EXAMINATION

OF THE

MIDSTATE MUTUAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2002

DATE OF REPORT:	JULY 11, 2003
EXAMINER:	GERARD L. FRANCO

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

George E. Pataki
Governor

Gregory V. Serio
Superintendent

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 22045 dated April 14, 2003, attached hereto, I have made an examination into the condition and affairs of the Midstate Mutual Insurance Company as of December 31, 2002 and submit the following report thereon.

The examination was conducted at the Company's home office located at 5612 Route 34, Auburn, New York 13021-0430.

Wherever the designations "the Company", or "MMIC" appear herein without qualification, they should be understood to indicate the Midstate Mutual Insurance Company

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1. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 1997. This examination covered the five year period from January 1, 1998 through December 31, 2002 and was limited in its scope to a review or audit of only those balance sheet items considered by this Department to require analysis, verification or description, including: invested assets, loss and loss adjustment expenses 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. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

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

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

2. DESCRIPTION OF COMPANY

The Company was organized in 1879 as the Farmers' Mutual Indemnity Insurance Association of Moravia, New York, for the purpose of transacting business as an assessment cooperative fire insurance corporation.

On April 8, 1986, the Department approved the merger of the Association with the Cayuga County Farmers Insurance Company, the Cayuga County Patron's Fire Relief Association, the Farmers' Reliance Mutual Insurance Company and the Southern Tier Cooperative Insurance Company, with the Association being the surviving corporation under the title, Midstate Mutual Insurance Company.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than nine or more than thirteen directors. As of the examination date, the board of directors was comprised of ten members, divided into three groups as evenly as possible, with one group being elected at each annual policyholder's meeting for a term of three years.

Each person insured by the Company is entitled to one vote in person at each of its annual meetings and no one may vote by proxy. The annual meeting of the board of directors is held immediately after the annual meeting of the Company. The full board met at least four times each year for the period under examination, thereby complying with Section 6624(b) of the New York Insurance Law.

The directors as of December 31, 2002 were as follows:

Director	Principal Business Affiliation
Gregory N. Bruce Auburn, NY	Secretary, MMIC
James P. Chamberlain Auburn, NY	Vice President, MMIC
Edwin D. Fessenden Kings Ferry, NY	Retired and Chairman of the Board, MMIC
Richard H. Flanagan Syracuse, NY	Director, Public Safety Training Center
John E. Johnson Rock Stream, NY	Insurance agent
John A. Karpinski Auburn, NY	Attorney
Lyndon R. Odell Union Springs, NY	Professional farm manager
Robert N. Potter Cicero, NY	Insurance Broker
Richard Waltman Apalachin, NY	Retired
Andrew P. White Auburn, NY	President, MMIC

The minutes of all meetings of the Board of Directors' and committees thereof held during the examination period were reviewed. Article III Section 3 of the Company's by-laws states that the compensation of the officers shall be set by the board of directors. Upon review of the board minutes the compensation of the president is established by the board of directors. The board minutes also indicate that the salary of the vice president and secretary are not approved by the board of directors. Therefore, it is recommended that the Company comply with Article III Section 3 of its by-laws and have salaries of all officers set by the board of directors.

The average attendance by the board of directors during the examination period was approximately 94%, with each individual directors' attendance being adequate at these meetings.

Each of the director's qualifications, as set forth in Article II Section 1 of the Company's by-laws, was reviewed and each director is duly qualified.

At December 31, 2002 the officers of the Company were as follows:

Chairman of the Board	Edwin D. Fessenden
President	Andrew P. White
Vice President	James P. Chamberlain
Secretary	Gregory N. Bruce
Treasurer	Richard Waltman

B. Territory and Plan of Operation

At December 31, 2002, the company was given authority to write insurance in all the Counties of the State of New York excluding the Counties of New York, Kings, Queens, Bronx and Richmond. The following schedule represents the Company's direct premiums written by year:

Calendar Year	Direct Premiums Written (000)s
1998	$4,266
1999	4,731
2000	6,044
2001	7,454
2002	9,475

The Company was licensed, as of December 31, 2002, to transact the kinds of businesses defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

Paragraph	Kind of Business
4	Fire
5	Miscellaneous Property
6	Water Damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine(inland marine only)

The Company added boiler and machinery insurance to its writing powers, upon approval of the Insurance Department, effective April 22, 2002. Both the Company's charter and license were amended to reflect this change in writing powers.

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

The Company underwrites predominantly commercial multiple peril and homeowners multiple peril lines of business, which accounted for 68% and 19%, respectively, of the 2002 net premium writings.

C. Reinsurance

The Company had no assumed reinsurance premiums written as of December 31, 2002.

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

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

As of December 31, 2002, the Company had the following multi-line excess of loss reinsurance program in place:

Property 4 layers	$1,450,000 x/s $50,000 ultimate net loss each risk each loss; subject to a further limit for each layer, respectively, of $150,000; $800,000; $1,000,000; and $1,000,000 in respect of each occurrence
Casualty 3 layers	$950,000 x/s $50,000 ultimate net loss each and every loss occurrence; subject to a further limit for each layer, respectively, of $50,000; $400,000; and $500,000 in respect of any one such loss occurrence
Casualty (Clash)	$2,000,000 x/s $1,000,000 ultimate net loss each and every loss occurrence

As of December 31, 2002, the Company had the following property catastrophe excess of loss reinsurance program in place:

Property catastrophe 2 layers	90% of $800,000 x/s $200,000 ultimate net loss each and every loss occurrence
	100% of $1,000,000 x/s $1,000,000 ultimate net loss each and every loss occurrence when two or more risks are involved

All of the Company’s cession during the period under examination were to authorized reinsurers. It is noted that the Company’s retention has remained at $50,000 on its property and casualty lines of business during the examination period.

Subsequent to the examination period, as of January 1, 2003, the reinsurance program of the Company was being underwritten by a different authorized reinsurer. The Company’s net retention under the new reinsurance program has been increased from $50,000 to $100,000 on both its property and casualty lines of business.

D. Holding Company System

The Company was not a member of any holding company system as of December 31, 2002. Furthermore, the Company had no affiliations or pooling agreements in force at December 31, 2002.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2002 based upon the results of this examination:

Net premiums written in 2002 to Surplus as regards policyholders	0.48 to 1
Premiums in course of collection to Surplus as regards policyholders	4.0%
Liabilities to cash and invested assets	36.0%

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

The underwriting ratios presented below are on an earned-incurred basis and encompass the five-year period, January 1, 1998 to December 31, 2002:

	Amounts	Ratios
Losses and loss adjustment expenses	$15,657,233	63.9%
Other underwriting expenses	10,081,067	41.1%
Net underwriting gain(loss)	(1,233,042)	(5.0)%
Premiums earned	$24,505,258	100.0%

F. Abandoned Property

Section 1316 of the New York State Abandoned Property Law provides that amounts payable to a resident of this state from a policy of insurance, if unclaimed for three years, shall be deemed to be abandoned property. Such abandoned property shall be reported to the comptroller on or before the first day of April each year. Such filing is required of all insurers regardless of whether or not they have any abandoned property to report.

The Company's abandoned property reports for the period of this examination were all filed on a timely basis pursuant to the provisions of Section 1316 of the New York State Abandoned Property Law.

G. Accounts and Records

i. Custodial Agreement

As indicated in the National Association of Insurance Commissioners(NAIC) Financial Condition Examiners Handbook there are specific guidelines that should be followed in the maintenance of a custodial or safekeeping agreement. After a review of the Company's current custodial agreement several provisions and safeguards required by the NAIC, reinforced by the Department's Circular Letter No. 2 of 1977 were found not to be included in the agreement. Therefore, it is recommended that the Company comply with NAIC requirements, reinforced by Circular Letter No. 2 of 1977 and obtain a custodial agreement that includes the requirements specified by the NAIC and the New York Insurance Department.

ii. Accounting

The money market held by the Company as of December 31, 2002 was classified as cash on Schedule E of the 2002 annual statement. As indicated in the annual statement instructions a money market fund should be classified as a common stock. It is therefore recommended that the Company comply with the annual statement instructions and move the money market funds to Schedule D Part 2 Section 2 of the annual statement. No examination change will be made as the amount is not material in relation to the Company's surplus.

Paragraph 4 of Statement of Statutory Accounting Principles No. 45(SSAP) of the Accounting Practices and Procedures Manual states that repurchase agreements shall be reported as short-term investments. At December 31, 2002 the Company showed repurchase agreements as cash on Schedule E of the annual statement. It is recommended that the Company comply with Paragraph 4 of SSAP No. 45 and record repurchase agreements as short-term investments on all financial statements filed with the Department. No examination change will be made as the amount is not material to the Company's surplus.

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, 2002. This statement is the same as the balance sheet filed by the Company.

Assets	Ledger Assets	Not Admitted Assets	Net Admitted Assets
Bonds	$19,152,901	$-0-	$19,152,901
Preferred stocks	51,200	-0-	51,200
Common stocks	814,366	-0-	814,366
Real Estate	830,497	-0-	830,497
Cash and short term investments	1,510,810	-0-	1,510,810
Other investments	5,271	5,271	-0-
Agents' balances or uncollected premiums	1,825,135	2,126	1,823,009
Reinsurance recoverables on loss and Loss adjustment expense payments	137,027	-0-	137,027
Federal and foreign income tax recoverable	446,700	44,200	402,500
Electronic data processing equipment	65,560	-0-	65,560
Interest, dividends and real estate income due and accrued	330,316	-0-	330,316
Other assets nonadmitted	120,766	120,766	-0-
Aggregate write-ins for other than invested assets	48,488	-0-	48,488
Total	$25,339,037	$172,363	$25,166,674

Liabilities and Surplus

Losses and loss adjustment expenses		$ 2,952,445
Commissions payable		440,508
Other expenses		17,614
Taxes,licenses and fees		5,144
Unearned premiums		4,600,693
Advance premiums		43,249
Ceded reinsurance premiums payable		347,693
Aggregate write-ins for liabilities		472,004
Total liabilities		$ 8,879,350
Unassigned funds(surplus)	$ 100,000	
Special contingent surplus	16,187,324	
Surplus as regards policyholders		16,287,324
Total		$25,166,674

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

B. Underwriting and investment exhibit

Surplus as regards policyholders increased $ 3,000,287 during the five-year examination period(January 1, 1998 through December 31, 2002) detailed as follows:

Statement of Income

Underwriting Income		
Premiums earned		$24,505,258
Losses and loss adjustment	$15,657,233	
Other underwriting expenses incurred	10,081,067	
Total Underwriting deductions		25,738,300
Net underwriting gain		$(1,233,042)
Investment Income		
Net investment income earned	$ 4,760,509	
Net realized capital gain(loss)	(47,276)	
Net investment gain		4,713,233
Other income		
Finance and service charge	$232,021	
Cumulative effect of changes in accounting principles	561,700	
Net other income		793,721
Net income before federal income taxes		$4,273,912
Federal income taxes incurred		1,066,358
Net income		$3,207,554

Capital and Surplus Account

	Gains in Surplus	Losses in Surplus	
Surplus as regards policyholders, December 31, 1997, per prior report on examination			$ 13,287,037
Net income or loss	$ 3,207,554	-0-	
Net unrealized capital gain	-0-	202,992	
Change in non-admitted assets	-0-	4,275	
Totals	$3,207,554	$207,267	
Net increase in Surplus as regards policyholders			3,000,287
Surplus as regards policyholders, December 31, 2002, per report on examination			$16,287,324

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liablility of $2,952,445 is the same as the $2,952,445 reported by the Company on its filed 2002 annual statement.

The Department's analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Company's internal records and in its filed annual statements.

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

5. MARKET CONDUCT ACTIVITIES

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

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

A. Sales and advertising

B. Underwriting

C. Rating

D. Claims

No unfair practices were encountered.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

Item	Page No.
A. It is recommended that the Company amend its custodial agreement to incude the Department's safeguards and controls	8

The Company did comply with this recommendation. However, the Department has introduced new guidelines concerning custodial agreements since the previous examination. See item G of this examination.

Item	Page No.
B. It is recommended that the Company properly complete its financial statements by recording pertinent call data in Schedule D, Part 1	8

The Company has complied with this recommendation.

Item	Page No.
C. It is recommended that the Company comply with Section 1305 of the Insurance Law and calculate this reserve based upon the terms of the policies rather than upon the month the premiums were received.	14
The Company has complied with this recommendation.	
D. It is recommended that the Company comply with Section 2324(a) of the New York Insurance Law and discontinue any agent commission tradeoffs.	14
The Company has complied with this recommendation.	

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

As indicated in the body of this report, the Company should be directed to comply with the following:

Item	Page No.
A. Management	
It is recommended that the Company comply with Article III Section 3 of its by-laws and have salaries of all officers set by the board of directors	3-4
B. Custodial Agreement	
It is recommended that the Company comply with NAIC requirements, reinforced by Circular Letter No. 2 of 1977 and obtain a custodial agreement that includes the requirements specified by the NAIC and the New York Insurance Department.	8

Item	Page No.
C. Accounting	
i. It is recommended that the Company comply with the annual statement instructions and move the money market funds to Schedule D Part 2 Section 2 of the annual statement.	9
ii. It is recommended that the Company comply with Paragraph 4 of SSAP No. 45 and record repurchase agreements as short-term investments on all financial statements filed with the Department.	9

Respectfully submitted,

/S/
Gerard L. Franco
Senior Insurance Examiner

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

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

/S/
Gerard L. Franco
Senior Insurance Examiner

Sworn to before me this

25th day of July, 2003

/S/
Notary Public

ANDREA M. CLARE
Notary Public, State of New York
Qualified in Montgomery County
No. 4636585
Commission Expires July 31, ~~19~~ 2006

Appointment No *22045*

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, GREGORY V. SERIO *, Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:*

Gerard Franco

as proper person to examine into the affairs of the

Midstate 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 Albany,

this 14th *day of April, 2003*

GREGORY V. SERIO
Superintendent of Insurance