



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

George E. Pataki
Governor

Gregory V. Serio
Superintendent

REPORT ON EXAMINATION
OF THE
PREFERRED MUTUAL INSURANCE COMPANY
AS OF
DECEMBER 31, 2001

DATE OF REPORT:

SEPTEMBER 20, 2002

EXAMINER:

WARREN YOUNGS

<http://www.ins.state.ny.us>

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September 20, 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 21856, dated March 14, 2002, attached hereto, I have made an examination into the condition and affairs of the Preferred 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 One Preferred Way, New Berlin, New York 13411.

Wherever the designations "the Company" or "PMIC" appear herein without qualification, they should be understood to indicate the Preferred Mutual Insurance Company.

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1. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 1996. This examination covered the five year period from January 1, 1997 through December 31, 2001, and was limited in its scope to a review or audit of only those balance sheet items considered by this Department to require analysis, verification or description, including: invested assets, inter-company balances, loss and loss adjustment expense reserves and the provision for reinsurance. The examination included a review of income, disbursements and company records deemed necessary to accomplish such analysis or verification and utilized, to the extent considered appropriate, work performed by the Company's independent certified public accountants.

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

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

2. DESCRIPTION OF COMPANY

The Company was organized in 1896 as the Preferred Mutual Fire Insurance Company of Chenango County, for the purpose of transacting business as a cooperative fire insurance corporation in Chenango County, New York. On December 27, 1910, a certificate was issued under the provisions of the New York Insurance Law, authorizing the Company to continue the transaction of business on the advance premium plan in ten counties of New York State.

The Company's charter was amended, on January 8, 1952, to provide for the transaction of business within the entire state of New York, and, wherever authorized by law, any other state, territories and possessions of the United States of America and the District of Columbia.

On November 27, 1939, the Company was authorized to issue non-assessable policies.

On February 19, 1957, a certificate was issued by this Department which authorized the Company to change its corporate title to the Preferred 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 nor more than twenty-five members. As of the examination date, the board of directors was comprised of ten members.

Four board meetings and one executive committee meeting were held in each of the years during the period under examination, thereby complying with Section 6624(b) of the New York Insurance Law.

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

<u>Director</u>	<u>Principal Business Affiliation</u>
Matthew Thomas Cooney, Jr. Norwich, NY	Retired
William Clarke Craine Sherburne, NY	Chairman of Granite Capital Holdings, Inc.
David Bruce Emerson Oxford, NY	Chairman of the Board of Blueox Corporation; Director of Preferred Services Corporation; Director of Preferred Group, Inc.
Everett Anson Gilmour Norwich, NY	Retired
Irad Steadman Ingraham New Berlin, NY	Retired
John Charles Mitchell Norwich, NY	President of I.L. Richer Company; Director of Preferred Services Corporation; Director of Preferred Group, Inc.
Geoffrey Adam Smith West Oneonta, NY	President of Medical Coaches, Inc.; Director of Preferred Services Corporation; Director of Preferred Group, Inc.

DirectorPrincipal Business Affiliation

Paul Oster Stillman
Norwich, NY

Chairman of the Board of PMIC; Director and
Chairman of Preferred Services Corporation;
Director and Chairman of Preferred Group, Inc.

Robert Arthur Wadsworth
New Berlin, NY

President and CEO of PMIC; Director and
President & CEO of Preferred Services
Corporation; Director and President & CEO of
Preferred Group, Inc.

William Clifton Westbrook
Charlotte, NC

Retired

The minutes of all of the Board of Directors' meetings and committees thereof held during the examination period were reviewed. Such review indicated that all of the meetings were well attended. Each of the directors had a satisfactory attendance record for the board meetings held.

Each of the director's qualifications, as set forth in Article V of the Company's charter and Article III Section 1 of its by-laws, was reviewed and it appears that each director was duly qualified.

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

Chairman of the Board
President and CEO
Senior Vice President, CFO and Treasurer
Senior Vice President and CIOO
Vice President
Vice President
Vice President
Corporate Secretary

Paul Oster Stillman
Robert Arthur Wadsworth
Christopher Paul Taft
Nunzio Louis DiGiuseppe
Raymond Chauncey Cower
James Lewis Crandall
William Fred Jardinella
Gary Graham Strong

B. Territory and Plan of Operation

The Company is licensed to transact business within the States of Massachusetts, New Hampshire, New Jersey, New York, Ohio, Pennsylvania, Rhode Island and South Carolina. The Company has a restricted "no new business" license for the state of North Carolina. In addition, the Company has a license for the state of Connecticut; however, it is only for servicing existing business.

Approximately 95% of the Company's 2001 direct writings were concentrated in New York, Massachusetts and New Jersey. The following schedule compares direct premiums written during the examination period in New York State with the total direct premiums written in the United States.

DIRECT PREMIUMS WRITTEN (000s)

<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>
1997	\$ 55,762	\$ 93,791	59.5%
1998	56,424	91,277	61.8%
1999	53,351	85,025	62.7%
2000	61,836	96,681	64.0%
2001	74,073	115,804	64.0%

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:

<u>Paragraph</u>	<u>Kind of Insurance</u>
4	Fire
5	Miscellaneous property
6	Water Damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
10	Elevator
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
16	Fidelity and surety
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine (inland marine only)

Based upon the lines of business for which the Company is licensed, and pursuant to the requirements of Articles 13, 41, and 66 of the New York Insurance Law, as of December 31, 2001, the Company is required to maintain a minimum surplus to policyholders in the amount of \$1,450,000.

The review of all the Company's licenses as of December 31, 2001 revealed that the Company has been licensed in other states for lines of business for which it does not have authority in its New York license, as follows: New Jersey-livestock & ocean marine; Massachusetts-livestock; Ohio-ocean marine; South Carolina-marine. Based upon research done by the Company, marine under South Carolina law includes what New York classifies as marine and inland marine.

The Company's minimum financial requirements and authority to do business is predicated upon its New York licensed authority pursuant to the provisions of Section 1102 and Articles 41 and 66 of the New York Insurance Law.

The Company is in the process of having its licenses outside this state conform to its New York license. Therefore, it is recommended that the Company complete the steps necessary to conform its licenses outside this state to its New York license.

At December 31, 2001, the Company wrote insurance through independent agents. The Company maintained a branch office in Norwich, New York.

The Company's predominate lines of business are homeowners multiple peril, private passenger auto liability, commercial multiple peril and auto physical damage, which accounted for 33.53%, 20.63%, 15.50% and 14.53%, respectively, of the Company's 2001 direct written business.

C. Reinsurance

The Company assumes a very minor volume of business as compared to its direct writings. The assumptions reflect the Company's participation in catastrophe and underwriting pools.

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

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

Property	<p>\$200,000 in excess of \$300,000 any one risk, subject to a cap of \$100,000 above policy limits and subject to a per occurrence limit of \$750,000 for other than Automobile physical damage;</p> <p>\$750,000 in excess of \$250,000 per occurrence, subject to a per occurrence limit of \$750,000 for Automobile physical damage.</p>
Casualty	\$3,750,000 in excess of \$ 250,000 any one loss occurrence.
Property catastrophe 4 layers	95% of \$ 36,000,000 in excess of \$4,000,000 any one loss occurrence, subject to a cumulative limit during the term of the agreements of \$68,400,000 on the first three layers; \$10,000,000 in excess of \$40,000,000 any one loss occurrence, subject to a limit during the term of the agreement of \$ 20,000,000 on the fourth layer.
Property aggregate 2 layers	<p>Reinsurers liability equal to 10% of the Company's net premiums earned or \$3,500,000, whichever is the greater, for losses occurring in excess of 75% of the Company net premiums earned;</p> <p>95% of net losses occurring in excess of 85% of the Company's net premiums earned subject to a maximum of 105% of net premiums earned.</p>

As of December 31, 2001, the Company had the following pro rata reinsurance programs in place:

Property quota share	30% of Company's business covered after deducting all other reinsurance inuring to this agreement, subject to a maximum cession per risk of \$300,000 and per occurrence of \$36,000,000.
Property first surplus	Personal lines—seven (7) times the Company's net retention on each risk, maximum \$3,500,000 each risk and Commercial lines—seven (7) times the Company's net retention on each risk, maximum \$3,500,000 each risk subject to an annual limit of 225% of the Company's ceded premium or \$5,000,000 whichever is the greater.
Casualty	Personal lines—95% of umbrella policies to \$1,000,000 and 100% of umbrella policies in excess of \$1,000,000 but not exceeding \$5,000,000; and Commercial lines— 95% of umbrella policies to \$1,000,000 each occurrence/\$1,000,000 aggregate and 100% of umbrella policies in excess of \$1,000,000 each occurrence/\$1,000,000 aggregate but not exceeding \$5,000,000 each occurrence/\$5,000,000 aggregate.

It is noted that the Company's quota share percentage of 30% did not change during the course of this examination.

As of December 31, 2001, the Company had the following facultative pro-rata reinsurance program in place:

Property	Three (3) times the Company's net retention on each risk, minimum \$4,000,000 each risk
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It is noted that 9.6% of the Company's reinsurance program was placed with unauthorized reinsurers. This is an increase from the prior examination where it was found that 3.4% was placed with unauthorized reinsurers.

In addition to the reinsurance described above, the Company had a reinsurance program for equipment breakdown coverage in effect at December 31, 2001. Under the terms of this reinsurance program, the Company ceded 100% of its liability for Business owners' policies to which Equipment Breakdown Coverage Endorsement Form No. PMBP04700689 or Form No. PMBP00700899 or subsequent editions are attached and Commercial Property Coverage Equipment Breakdown Coverage Endorsement where Forms No. PMCP04700695 or Form No. PMRI 00700899 or subsequent editions are attached.

Also during the course of this examination, the Company commuted its casualty aggregate reinsurance program. Under the terms of the commutation, the Company received \$936,882 to assume the liability for all outstanding reinsured losses, both known and unknown, effective October 20, 1998.

D. Holding Company System

The company had a wholly owned subsidiary Preferred Services Corporation as of the December 31, 2001, which in turn had wholly owned subsidiary Preferred Group, Inc. Preferred Group, Inc. is a licensed agent of the Company. The Company had "Technical Services Agreements" with both Preferred Services Corporation and Preferred Group Inc.

During the period under examination the Company's affiliation with the Leatherstocking Cooperative Insurance Company was dissolved.

E. Significant Operating Ratios

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

Net premiums written in 2001 to Surplus as regards policyholders	1.07 to 1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	62.58%
Premiums in course of collection to Surplus as regards policyholders	0.97%
Investment Yield	3.9%

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

The Company's Investment Yield for each of the years under examination were:

<u>Year</u>	<u>Investment Yield</u>
1997	4.1%
1998	3.9%
1999	3.6%
2000	3.7%
2001	3.9%

The benchmark range for the Investment Yield ratio is greater than 4.5% and less than 10%. As shown above, the Company failed the Investment Yield ratio each of the years under examination.

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

	<u>Amounts</u>	<u>Ratios</u>
Losses incurred	\$186,337,576	52.90%
Loss adjustment expenses incurred	38,568,880	10.95%
Other underwriting expenses incurred	126,717,194	35.97%
Aggregate write-ins for underwriting deductions	5,959,572	1.69%
Net underwriting gain (loss)	<u>(5,333,448)</u>	<u>(1.51)%</u>
Premiums earned	<u>\$352,249,774</u>	<u>100.00%</u>

F. Abandoned Property

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

It was discovered during the course of the examination that the Company was not escheating to the New York State Comptroller's Office amounts under \$25. The Company was writing these balances off and recording the amounts as income.

In correspondence, dated August 23, 2002, the Company acknowledged that checks for amounts under \$25 have not been reported as abandoned property. The correspondence also indicated that in the future all checks regardless of amount would be reported as abandoned property. In addition, the Company indicated that it is going to file a report to New York State, which will include those checks that should have been reported, but were not. Nevertheless, it is recommended that the Company escheat all amounts to the State Comptroller's Office required by the New York Abandoned Property Law, henceforth.

It is noted that the Company has written procedures related to the handling of unclaimed funds.

G. ACCOUNTS AND RECORDS

i. Allocation of Expenses

This Department's Regulation No. 30 (11NYCRR105-109) sets forth the rules and methods governing the allocation of expenses among the major expense group (loss adjustment, other underwriting and investment). This regulation also requires insurers to maintain detailed worksheets on file, supporting percentages used in allocating expenses to the various expense groups.

Management could not provide detailed worksheets to support the allocation of each expense category to a particular expense group. Thus, there was no viable way to determine whether the Company correctly allocated expenses, as per the rules found in the regulation.

In view of the above, management is directed to establish and maintain written documentation supporting the allocation of each expense category to the major expense groups as required by this Department's Regulation No. 30.

ii. Custodial agreement provisions

The Company maintained custodial agreements as of December 31, 2001, with NBT Bank.

The provisions of the Company's custodial agreements with the bank were reviewed to determine whether they were within the framework of the guidelines established by this Department for the contents of custodial agreements. The agreements were found to be deficient in several areas. After the above was brought to the attention of Company management they proceeded to enter into new agreements with the bank that did comply with the guidelines established by this Department for the contents of custodial agreements.

Nevertheless, it is recommended that should the Company enter into any new custodial agreements that it ensure that such agreements contain all the provisions established by this Department to be included in custodial agreements.

iii. Call dates and prices on bonds

The annual statement instructions require companies to report the call date and call price on which amortization is based for bonds purchased at a premium on Schedule D-Part 1 of the annual statement. The Preferred Mutual Insurance Company did not report the call date and call price on all applicable bonds as of the examination date. Therefore it is recommended that the Company comply with the annual statement instructions and report the call date and call price on which amortization is based for bonds purchased at a premium on Schedule D-Part 1 of future annual statements. A similar recommendation was included in the prior report.

iv. Approval of Investments

Section 1411(a) of the New York Insurance Law states, in part, that “No domestic insurer shall make any loan or investment ... unless authorized or approved by its board of directors or a committee thereof responsible for supervising or making such investment or loan. The committee’s minutes shall be recorded and a report submitted to the board of directors at its next meeting.”

The Company’s compliance with Section 1411(a) of the New York Insurance Law was reviewed for the period under examination. During such review it was found that the Company did not approve all of its long-term investments and short-term investments in accordance with Section 1411(a) of the New York Insurance Law.

After bringing the above to the attention of the Company management, they agreed to take corrective action regarding this matter. Nevertheless, it is recommended that the Company comply with the requirements of Section 1411(a) of the New York Insurance Law.

v. Repurchase Agreements and SSAP No. 45

As of December 31, 2001 the Company had \$4,427,013 invested under a repurchase agreement with NBT Bank. The value of the collateral received by PMIC was slightly over 100% of the amount it invested.

SSAP No. 45 section (8)(a) of the Statement of Statutory Accounting Principles indicates that the “reporting entity shall receive as collateral transferred securities having a fair value at least equal to 102 percent of the purchase price paid by the reporting entity for the securities.”

In view of the above, it is recommended that the Company adhere to the requirements of SSAP No. 45 section (8)(a) when entering into repurchase agreements in the future.

vi. Annual Statement Schedule P

The Company did not complete Schedule P-Part 5 (claim counts) in its filed 2000 and 2001 Annual Statements. During the course of this exam, the Company did provide the completed 2000 and 2001 Schedule P-Part 5's. Nevertheless, it is recommended that the Company complete Schedule P Part 5 of all future annual statements in accordance with the annual statement instructions.

During the review of the 2001 Annual Statement Schedule P Part 1 Summary, it was found that the amount of loss adjusting expenses indicated as paid therein did not agree to the amount of loss adjusting expenses paid per the 2001 Annual Statement Underwriting and Investment Exhibit-Part 4. In correspondence dated August 28, 2002, Company management acknowledged that Schedule P Part 1 was incorrect, in that LAE expenses did not tie to Part 4 column 1. Management also indicated that going forward, the Company would ensure such amounts agree. Nevertheless, it is recommended that in future annual statements the Company ensure that the amounts reported in Schedule P agree with the applicable amounts reported in other parts of the annual statement.

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. This statement is the same as the balance sheet filed by the Company. The figures included in these financial statements have been rounded.

<u>Assets</u>	<u>Ledger Assets</u>	<u>Non Admitted Assets</u>	<u>Net Admitted Assets</u>
Bonds	\$125,526,922		\$125,526,922
Preferred stocks	636,406		636,406
Common stocks	39,517,764		39,517,764
Real estate	5,271,646		5,271,646
Cash on hand and on deposit	(2,057,703)		(2,057,703)
Short-term investments	9,434,310		9,434,310
Receivable for securities	675,296		675,296
Agents' balances or uncollected premiums	25,998,900	383,785	25,615,115
Funds held by or deposited with reinsured companies	51,037		51,037
Reinsurance recoverables on loss and loss adjustment expense payments	1,604,000		1,604,000
Electronic data processing equipment	16,333	16,333	
Interest, dividends and real estate income due and accrued	1,942,623		1,942,623
Equities and deposits in pools and associations	413,866		413,866
Other assets non-admitted	347,656	347,656	
Cash surrender value	2,606,674		2,606,674
Equity in fair plans	663,164		663,164
Prepaid expenses	1,597,084	1,522,377	74,707
NJ P/L guaranty recoupment	<u>1,763</u>	<u> </u>	<u>1,763</u>
Total assets	<u>\$214,247,741</u>	<u>\$2,270,151</u>	<u>\$211,977,590</u>

Liabilities & Surplus

Losses		\$47,254,646
Reinsurance payable on paid loss and loss adjustment expenses		17,938
Loss adjustment expenses		11,988,053
Contingent commissions and other similar charges		4,050,000
Other expenses (excluding taxes, licenses and fees)		7,061,628
Taxes, licenses and fees (excluding federal and foreign income taxes)		238,159
Federal and foreign income taxes (excluding deferred taxes)		903,808
Unearned premiums		47,392,270
Ceded reinsurance premiums payable (net of ceding commissions)		3,388,006
Funds held by company under reinsurance treaties		443,194
Amounts withheld or retained by company for account of others		5,618,224
Provision for reinsurance		1,000
Drafts outstanding		81,053
Payable to parent, subsidiaries and affiliates		<u>197,776</u>
Total liabilities		128,635,755
Required surplus	\$ 1,450,000	
Unassigned funds (surplus)	<u>81,891,835</u>	
Surplus as regards policyholders		<u>\$83,341,835</u>
Total liabilities and surplus as regards policyholders		<u>\$211,977,590</u>

The Internal Revenue Service has completed its audits of the Company's consolidated federal income tax returns filed through tax year 1995. Audits covering subsequent tax years have yet commence. 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 by \$35,003,265 during the five-year examination period, January 1, 1997 to December 31, 2001, detailed as follows:

Statement of IncomeUnderwriting Income

Premiums earned		\$352,249,774
Losses incurred	\$186,337,576	
Loss adjustment expenses incurred	38,568,880	
Other underwriting expenses incurred	126,717,194	
Aggregate write-ins for underwriting deductions	<u>5,959,572</u>	
Total underwriting deductions		<u>357,583,222</u>
Net underwriting gain (loss)		\$(5,333,448)

Investment Income

Net investment income earned	\$ 32,256,608	
Net realized capital gains or (losses)	<u>4,569,452</u>	
Net investment gain or (loss)		36,826,060

Other Income

Net loss from agents' or premium balances charged off	\$(1,205,154)	
Finance and service charges not included in premiums	6,712,160	
Aggregate write-ins for miscellaneous income	<u>535,476</u>	
Total other income		<u>6,042,482</u>
Net income before federal income taxes		\$ 37,535,094
Federal income taxes incurred		<u>8,591,736</u>
Net income (loss)		<u>\$ 28,943,358</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 1996, per prior report on examination			\$48,338,570
	<u>Gain in Surplus</u>	<u>Losses in Surplus</u>	
Net income or loss	\$28,943,358	\$ 0	
Net unrealized capital gain or (losses)	9,188,434	0	
Change in not-admitted assets	0	1,428,739	
Change in provision for reinsurance	9,889	0	
Cumulative effect of changes in accounting principles	0	783,142	
Aggregate write-ins for gains and losses in surplus	<u>0</u>	<u>926,535</u>	
Total gains and losses	<u>\$38,141,681</u>	<u>\$3,138,416</u>	
Net increase in surplus as regards policyholders			<u>35,003,265</u>
Surplus as regards policyholders, December 31, 2001 per report on examination			<u>\$83,341,835</u>

4. LOSSES

The examination liability of \$47,254,646 is the same as the amount reported by the Company in its 2001 filed annual statement.

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

The Department's analysis indicated that the Company's loss reserves appeared adequate as of December 31, 2001.

5. LOSS ADJUSTMENT EXPENSES

The examination liability of \$11,988,053 is the same as the amount reported by the Company in its 2001 filed annual statement.

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

The Department's analysis indicated that the Company's loss adjustment expense reserves appeared adequate as of December 31, 2001.

6. 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:

- 1) Sales and advertising
- 2) Underwriting
- 3) Rating
- 4) Treatment of policyholders and claimants

Except as noted below, no unfair practices were encountered.

Department Regulation 58

The Company has had a Mass Marketing Program for Homeowners in effect since 1973 and for Personal Automobile in effect since 1999.

Section 13.6 of this Department's Regulation No. 58 (11 NYCRR 13) requires annual reports of premiums, losses and expenses by line of coverage, to be filed with the Superintendent for each calendar

year no later than April 1st of the following year, from insurers selling insurance pursuant to a mass merchandising plan.

During the course of this examination, it was found that the Company had failed to file the required reports since at least 1999. Therefore, it is recommended that the Company file annual reports required by Department Regulation No. 58 Section 13.6 by the filing deadline of April 1st, henceforth.

Section 3425 of the Insurance Law

During the review of cancellation notices issued by the Company, the following was found:

1. The Company issued personal line cancellation notices on policies in effect sixty days or less that did not contain the specific reason or reasons for cancellation in violation of Section 3425(b) of the New Insurance Law.
2. The Company issued personal line mid-term cancellation notices for other than statutory reasons in violation of Section 3425(c) of the New York Insurance Law.

In correspondence, dated July 24, 2002, Company management indicated that the Company would comply regarding the matters noted above. Nevertheless, it is recommended that the Company comply with the provisions of Section 3425(b) of the New York Insurance Law when issuing notices of cancellation on policies in effect sixty days or less by including the specific reason or reasons for cancellation in such notice. In addition, it is recommended that the Company not issue personal line mid-term cancellations for other than statutory reasons as required by Section 3425(c) of the New York Insurance Law.

7. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>Item</u>	<u>Page No.</u>
A. Recommendation that the Company increase its special contingent surplus from \$1,300,000 to \$1,450,000, to comply with Articles 13 and 41 of the New York Insurance Law.	7

<u>Item</u>	<u>Page No.</u>
The Company has complied with this recommendation.	
B. Recommendation that the Company comply with Section 1209(f) of the New York Insurance Law and cease agreeing to make compensation payments to its officers under the Annual Performance Plan, unless amended accordingly.	11-12
The Company has complied with this recommendation.	
C. i. Recommendation that the Company treat 1/6 of the reinsurance ceded to MRB as unauthorized reinsurance on future financial statements filed with this Department.	12
The Company has complied with this recommendation.	
ii. Recommendation that MRB's president's signature be obtained on all existing and future reinsurance contracts issued to PMIC.	12-13
The Company has complied with this recommendation.	
D. Recommendation that the Company comply with the annual statement instructions and report all call dates and call prices on Schedule D-Part 1 of all future annual statements.	13
The Company has not fully complied with this recommendation. See section 2(G)(iii) of this report.	
E. Recommendation that when the Company sends an insured a mandatory explanation letter, the required wording as set forth in Regulation 64 Part 216.7 be prominently displayed in such letter.	21
The Company has substantively complied with this recommendation.	

8. SUMMARY OF COMMENTS AND RECOMMENDATIONS

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

<u>Item</u>	<u>Page No.</u>
<p>A. <u>Territory and Plan of Operation</u></p> <p>It is recommended that the Company complete the steps necessary to conform its licenses outside this state to its New York license.</p>	6
<p>B. <u>Abandoned Property</u></p> <p>It is recommended that the Company escheat all amounts to the State Comptroller's Office required by the New York Abandoned Property Law, henceforth.</p>	10
<p>C. <u>Accounts and Records</u></p>	
<p style="padding-left: 20px;">i. <u>Allocation of Expenses</u></p> <p>Management is directed to establish and maintain written documentation supporting the allocation of each expense category to the major expense groups as required by Department Regulation 30.</p>	11
<p style="padding-left: 20px;">ii. <u>Custodial agreement provisions</u></p> <p>It is recommended that should the Company enter into any new custodial agreements that it ensure that such agreements contain all the provisions established by this Department to be included in custodial agreements.</p>	11
<p style="padding-left: 20px;">iii. <u>Call dates and prices on bonds</u></p> <p>It is recommended that the Company comply with the annual statement instructions and report the call date and call price on which amortization is based for bonds purchased at a premium on Schedule D-Part 1 of future annual statements. A similar recommendation was included in the prior report.</p>	12

<u>Item</u>	<u>Page No.</u>
iv. <u>Approval of Investments</u>	12
It is recommended that the Company comply with the requirements of Section 1411(a) of the New York Insurance Law.	
v. <u>Repurchase Agreements and SSAP No. 45</u>	13
It is recommended that the Company adhere to the requirements of SSAP 45 section (8)(a) when entering into repurchase agreements in the future.	
vi. <u>Annual Statement Schedule P</u>	13
a) It is recommended that the Company complete Schedule P Part 5 of all future annual statements in accordance with the annual statement instructions.	
b) It is recommended that in future annual statements the Company ensure that the amounts reported in Schedule P agree with the applicable amounts reported in other parts of the annual statement.	
D. <u>Market Conduct Activities</u>	19
i. It is recommended that the Company file the annual reports required by Department Regulation 58 Section 13.6 by the filing deadline of April 1 st , henceforth.	
ii. It is recommended that the Company comply with the provisions of Section 3425(b) of the New York Insurance Law when issuing notices of cancellation on policies in effect sixty days or less by including the specific reason or reasons for cancellation in such notice.	
iii. It is recommended that the Company not issue personal line mid-term cancellation for other than statutory reasons as required by Section 3425(c) of the New York Insurance Law.	

Appointment No 21856

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:

Warren Youngs

as proper person to examine into the affairs of the

Preferred Mutual Insurance Company

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

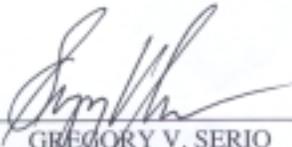
Company

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 14th day of March, 2002





GREGORY V. SERIO
Superintendent of Insurance

