



STATE OF NEW YORK  
INSURANCE DEPARTMENT  
AGENCY BUILDING ONE  
EMPIRE STATE PLAZA  
ALBANY, NY 12257

REPORT ON EXAMINATION  
OF THE  
STERLING INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2000

DATE OF REPORT:

JANUARY 18, 2002

EXAMINER:

GERARD L. FRANCO



STATE OF NEW YORK  
INSURANCE DEPARTMENT  
AGENCY BUILDING ONE  
EMPIRE STATE PLAZA  
ALBANY, NY 12257

January 18, 2002

Honorable Gregory V. Serio  
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 No. 21761 dated July 31, 2001, attached hereto, I have made an examination into the condition and affairs of the Sterling Insurance Company as of December 31, 2000 and submit the following report thereon. The examination was conducted at the Company's home office, located at Barnerville Road, Cobleskill, New York 12043-0009.

Whenever the designations "the Company", or "SIC" appear herein without qualification, they should be understood to indicate the Sterling Insurance Company.

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## 1. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 1996. This examination covered the four year period from January 1, 1997 through December 31, 2000, 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 public accountants. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

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 on October 17, 1895, as the Schoharie and Otsego Mutual Fire Insurance Company for the purpose of transacting business as a co-operative fire insurance corporation in Schoharie and Otsego Counties. On December 10, 1910, this Department

authorized the Company to continue the transaction of business on the advance premium plan in seven counties located in the central and eastern parts of this state.

On June 20, 1911, the charter was amended to permit the Company to extend its territory to include all of the counties of this state with the exception of the counties of New York, Kings, Queens, Bronx and Richmond.

Under Agreements of Merger approved by this Department, the Company merged with the Empire Co-operative Fire Insurance Company, of Middleburgh, New York and the Wyoming Valley Fire Insurance Company, of Warsaw, New York in September 1951 and June 1953, respectively, under the title and charter of Sterling Fire Insurance Company.

Pursuant to Section 805 of the Business Corporation Law, a Certificate of Change of Name was approved on May 20, 1959, amending the charter of the Company to reflect the name, Sterling Insurance Company, and extending its territory to include the entire state of New York.

#### 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 eleven (11) nor more than thirteen (13) members. As of the examination date, the board of directors was comprised of eleven members, divided into three groups as nearly equal as possible, with one group being elected at each annual policyholders' meeting for a term of three years.

Each person insured by the Company is entitled to one vote in person by proxy at any and all meetings of the Company. The annual meeting of the board of directors is held immediately

after the annual meeting of the Company. At least four board meetings were held each year for the period under examination, thereby complying with Section 6624(b) of the New York Insurance Law.

The board of directors membership at December 31,2000, was as follows:

<u>Director</u>	<u>Principal Business Affiliation</u>
J. Lewis DuMond Cobleskill, NY	Retired Insurance Agent
John M. Holmes Cherry Valley, NY	Retired Veterinarian
Henry Lamont Cobleskill, NY	CEO, Lamont Engineers
Henry Lee Cobleskill, NY	Retired Pharmacist
Frederick J. Lindsay Cobleskill, NY	Retired Retailer
Patricia A. MacNeil Cobleskill, NY	Secretary & Vice President, Human Resources of SIC
Loren F. Rodewig Cobleskill, NY	Vice President of SIC
Daniel B. Schutte Cobleskill, NY	Building Contractor
Howard J. Stauble Cobleskill, NY	Treasurer of SIC
Paul H. Stauble Cobleskill, NY	President & CEO of SIC
Donald R. Whiting Slingerlands, NY	Insurance Agent

The minutes of all meetings of the Board of Directors' and committees thereof held during the examination period were reviewed. The average attendance by the board of directors during the examination period was approximately 99% with each individual directors' attendance being adequate at these meetings, unless otherwise indicated.

Each of the directors' qualifications, as set forth in Article IV of the Company's by-laws, were reviewed, and it appears that each director is duly qualified.

At December 31, 2000, the officers of the Company were as follows:

President	Paul H. Stauble
Treasurer	Howard J. Stauble
Secretary & Vice President	Patricia A. Mac Neil
Vice President	Loren Rodewig

B. Territory and Plan of Operation

The following schedule shows direct premiums written by SIC in New York State for the examination period:

<u>Calendar Year</u>	<u>Total Direct Premium Written(000's)</u>
1997	\$26,226
1998	26,554
1999	26,932
2000	27,831

As of the examination date, 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 Business</u>
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass
12	Collision
13	Personal injury liability
14	Property damage liability
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine(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, the Company is required to maintain a minimum surplus to policyholders in the amount of \$650,000.

The Company's predominate lines of business are homeowners multiple peril, commercial multiple peril and private passenger automobile liability, which accounted for 51.1%, 27.8% and 8.7% respectively, of the Company's 2000 direct written business. Approximately 11% of the Company's total direct written premiums were attributable to New York Mutual Underwriters.

### 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 a catastrophe pool.

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, 2000, the Company had the following excess of loss reinsurance program in place:

Property 2 layers	\$675,000 in excess of \$175,000 any one risk, subject to an occurrence limit of \$375,000 on the first layer and \$1,650,000 on the second layer
Casualty 3 layers	\$1,850,000 in excess of \$150,000 any one loss occurrence
Property catastrophe 4 layers	\$18,000,000 in excess of \$ 1,000,000 any one loss occurrence, subject to a limit during the term of the agreement of \$1,000,000 on the first layer, \$4,000,000 on the second layer, \$15,000,000 on the third layer and \$16,000,000 on the fourth layer.
Property aggregate 2 layers	100% of the amount net aggregate losses for each accident year exceed 74% of subject net earned premium, to a maximum limit of liability of \$750,00. 100% of the amount net aggregate losses for each accident year exceed 74% of the subject net earned premium plus \$750,000, to a maximum limit of liability of \$1,250,000.

As of December 31, 2000, the Company had the following quota share reinsurance program in place:

Property and casualty	10% of Company's business covered after deducting all other reinsurance inuring to this agreement.
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It is noted that the Company, as of July 1, 2000, decreased its quota share percentage to 10% which increased its net retention on property business to \$157,500, and increased its retention on casualty business to \$135,000.

As of December 31, 2000, the Company had a quota share reinsurance program in place for its personal liability umbrella business. This reinsurance covered 95% of \$1,000,000(\$950,000) each occurrence and/or in the aggregate where applicable, any one original insured.

It is noted that one-sixth of each of the above contracts was placed with an unauthorized reinsurer.

As of December 31, 2000, the Company had in effect a personal automobile glass breakage reinsurance agreement, which covered the comprehensive portion of the Company's personal automobile policies for vehicles principally garaged in New York State. The liability of the reinsurer for the cost of replacement glass and adjustment expenses, in any single occurrence, shall not exceed the comprehensive portion of the Company's personal automobile policy.

#### D. Holding Company System; Pools and Affiliations

In February 1993, the Department approved the organization of a wholly owned subsidiary named Sterling Marketing Services, Inc. ("SMS"). SMS was organized to act as a general insurance agency for insurers other than Sterling and to solicit placement of insurance policies with such insurers' agents.

Sterling Insurance Company contributed capital to the subsidiary by purchasing 50 shares of no par common stock at \$400 per share, for a total investment of \$20,000.

SMS is housed at the Company's home office. Sterling Insurance Company provides services to SMS in accordance with an "Agreement and Statement of Policy" between the two companies.

The Company, from the period January 1, 1997 through November 1, 1997, participated on a 1/3 share basis in non-assessable combination policies issued under the name, New York Mutual Underwriters ("NYMU"). After November 1, 1997, the Company shares with one other advance premium corporation one-half of all New York Mutual Underwriter's premiums, losses and expenses according to the Articles of Agreement of this underwriting association. NYMU's predominate lines of business are commercial/special multiple peril, commercial landlord, personal dwellings and allied line of business.

#### E. Significant Operating Ratios

The following ratios have been computed, as of December 31, 2000, based upon the results of this examination:

Net premiums written in 2000 to surplus as regards policyholders	1.36 to 1
Liabilities to liquid assets(cash and invested assets less investments in affiliates	68%
Premiums in course of collection to surplus as regards policyholders	11%

The aforementioned ratios fall within the benchmark ranges as 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 four-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses & Loss adjustment expenses incurred	\$45,592,390	59.89%
Other underwriting expenses incurred	29,477,952	38.72%
Net underwriting gain(loss)	<u>1,056,127</u>	<u>1.39%</u>
Premiums earned	<u>\$76,126,469</u>	<u>100.00%</u>

F. Abandoned Property

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

It is noted that the Company has in effect written procedures for the handling of unclaimed funds, to ensure that outstanding checks are subject to follow-up procedures on a periodic basis.

3. FINANCIAL STATEMENTS

A. Balance sheet

The following show the assets, liabilities and surplus as regards policyholders as determined by this examination as of December 31,2000. This statement is the same as the balance sheet filed by the Company.

<u>Assets</u>	Ledger <u>Assets</u>	Non-Ledger <u>Assets</u>	Not Admitted <u>Assets</u>	Net Admitted <u>Assets</u>
Bonds	\$28,491,217	-0-	\$198,430	\$28,292,787
Common stocks	2,364,928	1,476,561	-0-	3,841,489
Real Estate	1,826,415	-0-	-0-	1,826,415
Cash and short term investments	4,064,062	-0-	-0-	4,064,062
Agents' balances or uncollected premiums	4,027,321	-0-	14,933	4,012,388
Reinsurance recoverable on loss and loss adjustment expenses	128,636	-0-	-0-	128,636
Electronic data processing equipment	99,824	-0-	-0-	99,824
Interest, dividends and real estate income due and accrued	-0-	386,557	-0-	386,557
Equities in pools & associations	-0-	596,885	1,047	595,838
Other assets nonadmitted	97,118	-0-	97,118	-0-
Aggregate write-ins for other than invested assets	<u>89,187</u>	<u>-0-</u>	<u>-0-</u>	<u>89,187</u>
Total	<u>\$41,188,708</u>	<u>\$2,460,003</u>	<u>\$311,528</u>	<u>\$43,337,183</u>

Liabilities and Surplus

Losses and loss adjustment expenses		\$10,776,774
Contingent commissions and other similar charges		521,704
Other expenses		254,047
Taxes, licenses and fees		20,292
Federal and foreign income taxes		253,692
Unearned premiums		13,606,085
Amounts withheld or retained by company for account of others		7,292
Aggregate write-ins for liabilities		<u>731,184</u>
Total liabilities		\$26,171,070
Unassigned funds(surplus)	\$16,279,749	
Special contingent surplus	<u>886,364</u>	
Surplus as regards policyholders		<u>17,166,113</u>
Total		<u>\$43,337,183</u>

The Internal Revenue Service has not performed an audit of the Company's federal income tax returns for any tax year during the examination period.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$6,902,922 during the four-year examination period, (January 1, 1997 to December 31, 2000) detailed as follows:

Statement of Income

Underwriting Income

Premiums earned		\$76,126,469
Losses & Loss adjustment expenses incurred	\$45,592,390	
Other underwriting expenses incurred	<u>29,477,952</u>	
Total underwriting deductions		<u>75,070,342</u>
Net underwriting gain(loss)		\$ 1,056,127

Investment Income

Net investment income earned	\$ 6,603,170	
Net realized capital gain	<u>362,168</u>	
Net investment gain		6,965,338

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$(112,703)	
Finance and service charges not included in premium	2,030,397	
LAD program expenses	(920,767)	
Aggregate write-ins for miscellaneous income	<u>658,829</u>	
Total other income		1,655,756
Net income before federal income taxes		<u>\$9,677,221</u>
Federal income taxes incurred		3,253,500
Net income		<u>\$6,423,721</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 1996 per prior report on examination			\$10,263,191
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income or loss	\$6,423,721	-0-	
Net unrealized capital gains or losses	<u>479,201</u>	<u>-0-</u>	
Total gains and losses	\$6,902,922	\$-0-	
Net increase in surplus as regards policyholders			<u>6,902,922</u>
Surplus as regards policyholders, December 31, 2000, per report on examination			<u>\$17,166,113</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability of \$ 10,776,774 is the same as the \$10,776,774 reported by the Company on its filed 2000 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, in the aggregate, the Company's loss and loss adjustment expenses reserves were adequate.

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

Except as noted below, no unfair practices were encountered.

Cancellations were reviewed for Company compliance with Section 3425(d)(1) and 3426(e)(2) of the New York Insurance Law. It was found in several instances that only general reasons, such as "previous payment history" and "claim history with this company", were given for the cancellation. The above mentioned reasons are too broad in nature and do not comply with the specificity required by the above-cited laws. Therefore, it is recommended that the Company comply with Section 3425(d)(1) and 3426(e)(2) of the New York Insurance Law and give a more detailed description of the reason for the cancellation.

In the review of the Company's claim denial letters, it was revealed that the Department's address was not included in such denial letters. This information is required by Section 216.6(h) of this Department's regulation No 64 (11NYCRR216) to be included in any notice rejecting any element of a claim involving personal property. It is recommended that the Company comply with all the requirements of Section 216.6(h) of Regulation No 64 by including all required information in each claim denial letter.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>Item</u>	<u>Page No.</u>
A. It is recommended that in future financial statements filed with this Department, the Company complete Schedule F in accordance with NAIC instructions, and properly classify its reinsurers as authorized or unauthorized. It is noted that a similar recommendation was included in the prior report.	7

The Company has complied with this recommendation.

B. It is recommended that the company ensure that any future reinsurance contracts it enters into with MRB are properly executed.	7
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The Company has complied with this recommendation.

C. The Company should either seek the Department's permission to exceed the ceded reinsurance benchmark of Section 1308(e)(1)(A) of the New York Insurance Law on a case-by-case basis or forward all reinsurance contracts in force and future addendums thereto, to the Department for approval as they are implemented. 10

The Company has complied with this recommendation

D. It does not appear to be reasonable to spend money belonging to all of the policyholders in order to send out proxy statements, which also include notice of the annual meeting, to only a few of the Company's policyholders. It is noted that a notice of the annual meeting is included in each policy issued. 13

The company has developed a procedure to comply with this comment.

E. The Department is currently reviewing its position with regard to the use of subcustodians to hold insurance company securities. The manner in which the Company's securities are being held will be subject to further review once the Department's official position with regard to the use of subcustodians has been determined. 13-14

The Company has complied with the Department's current position on the use of subcustodians.

F. It is recommended that if the Company enters into any new custodian arrangements in the future, such arrangements be established in a manner that would ensure compliance with Section 1411(b) of the New York Insurance Law 14

The Company has complied with this recommendation.

G. It is recommended that management establish and maintain written documentation verifying that Department Regulation 30 has been followed in allocating expenses among the major expense groups for all future financial statements filed with this Department. It is noted that a similar recommendation was made in the previous report on examination. 14-15

The Company has complied with this recommendation.

H. It is noted that the Company is involved in litigation that is not customary in the insurance business or originating from reinsurance contracts. 15-16

A court decision has been rendered on the above litigation and has been resolved.

I. It is recommended that the Company follow the annual statement instructions and report asset, "Agents' Balances or Uncollected Premiums", net as to commissions payable thereon, in future statements filed with this Department. 20

The Company has complied with this recommendation

J. It is recommended that the Company account for any commissions receivable on its reinsurance ceded business as a reduction of its ceded reinsurance balances payable amount, as prescribed by the NAIC'S Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies", in future statements filed with this Department. 20

The Company has complied with this recommendation.

K. It is recommended that the Company correct the Schedule P claim count information to ensure that future Schedule P's filed with this Department are accurate and can be relied on. 21

The Company has complied with this recommendation.

L. It is recommended that the Company include a 'Provision for reinsurance' in all future financial statements to be filed with this Department, when applicable 22-23

The Company has complied with this recommendation.

M. It is recommended that the Company comply with all the provisions of Department Regulation 96(anti-arson applications), henceforth. 24-25

The Company has complied with this recommendation.

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

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

Item	Page No.
A. MARKET CONDUCT ACTIVITIES	
i. It is recommended that the Company comply with Section 3425(d)(1) and 3426(e)(2) of the New York Insurance Law and give a more detailed description of the reason for the cancellation	15
ii. It is recommended that the Company comply with all the requirements of Section 216.6(h) of Regulation No. 64 (11NYCRR216) by including all required information in each claim denial letter	16

Appointment No 21761

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 L. Franco**

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

**Sterling Insurance Company**

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

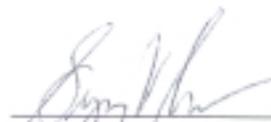
**Company**

*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 31st day of July, 2001*



  
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GREGORY V. SERIO  
Superintendent of Insurance

