

REPORT ON EXAMINATION
OF THE
USAGENCIES DIRECT INSURANCE COMPANY
AS OF
DECEMBER 31, 2001

DATE OF REPORT

JANUARY 20, 2003

EXAMINER

MICHAEL WYSS

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

George E. Pataki
Governor

Gregory V. Serio
Superintendent

January 20, 2003

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 Number 21949 dated November 4, 2002 attached hereto, I have made an examination into the condition and affairs of USAgencies Direct Insurance Company as of December 31, 2001, and submit the following report thereon.

The examination was conducted at the administrative offices of the Company's parent, USAgencies, L.L.C., located at 8550 United Plaza Blvd., Suite 805, Baton Rouge, Louisiana. The Company has received permission to maintain its records outside the State of New York pursuant to Section 325(b) of the New York Insurance Law.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate USAgencies Direct Insurance Company.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York Insurance Department.

1. SCOPE OF EXAMINATION

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

The examination comprised a complete verification of assets and liabilities as of December 31, 2001. 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
- Growth of Company
- Business in force by states
- Loss experience
- 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 contained in the prior report on organization.

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

2. DESCRIPTION OF COMPANY

A. History

The Company was incorporated under the laws of the State of New York on April 1, 1989, as a vehicle for the domestication of the U.S. Branch of Caledonian Insurance Company of London, England. On July 31, 1995, the Company became Caledonian Insurance Company of America, a New York domestic company. From 1996 to 1999, Atlas Assurance Company of America, a subsidiary of GRE-USA Corporation, held all of the outstanding capital stock of the Company. During 1999, the outstanding capital stock of the Company was acquired by USAgencies, L.L.C., an insurance holding company domiciled in Louisiana. The acquisition was approved by the Department on April 29, 1999. The Department approved the Company's current name on August 9, 1999.

Capital paid in is \$2,500,000 consisting of 2,500,000 shares of common stock at \$1 par value per share. Gross paid in and contributed surplus is \$500,000. There were no changes in gross paid in and contributed surplus during the examination period.

B. 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 thirteen or more than twenty-one members. The board met annually during the examination period. At December 31, 2001, the board of directors was comprised of the following 13 members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Donald Bollinger Lockport, LA	Chief Executive Officer, Bollinger Shipyards, Inc.
Kevin Couhig Baton Rouge, LA	President and Chief Executive Officer, Source Capital Corporation

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Dr. Murray A. Decouteau Baton Rouge, LA	Retired Dentist
Roy D. Duckworth III Rye, NY	Attorney, Meadors, Duckworth and Moore
Norman F. Ernst Jr. Orchard Park, NY	President and Chairman, NOVA American Group
Jesse O. Griffin Baton Rouge, LA	Senior Vice President and Controller, United Financial Companies
Peter W. Mattingly Larchmont, NY	Insurance Consultant
Timothy P. McKey Baton Rouge, LA	Certified Public Accountant, Burris, McKey, O'Brien, CPA
S. Gordon Miller Baton Rouge, LA	Treasurer, USAgencies, L.L.C.
Kevin Reilly, Jr. Baton Rouge, LA	Chief Executive Officer, Lamar Corporation
Charles K. Slatery Memphis, TN	Vice President, New South Capital Management
Gregory W. Tramontin Baton Rouge, LA	President and CEO, USAgencies, L.L.C.
Thomas H. Turner Baton Rouge, LA	President, Turner Industries, Inc.

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended with the exception of Donald Bollinger, whom attended only one of the annual meetings between 1999 and 2001.

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. It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.

Conflict of interest statements signed by officers and directors of the Company were not available for review for the years under examination. However, signed conflict of interest statements for 2002 were obtained.

It is recommended the Company maintain conflict of interest statements at its home office for each year subject to examination.

A review of the board of directors minutes indicated that the minutes did not disclose the members of the board elected to the investment and audit committees. In addition, it was noted that the minutes did not contain a listing of the Company's investments approved by the board.

It is also recommended that members of the investment and audit committees be identified and named in the board minutes when elected to the committees.

It is recommended that the Company attach a listing of the investments approved by the board in either the minutes or as an attachment or exhibit.

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

<u>Name</u>	<u>Title</u>
Gregory W. Tramontin	President
S. Gordon Miller	Secretary and Treasurer

C. Territory and Plan of Operation

As of December 31, 2001, the Company was licensed to write business in 15 states. Subsequent to the examination, the Company was licensed in Louisiana.

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>Line of Business</u>
4	Fire
5	Miscellaneous property damage
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
12	Collision
13	Personal injury liability
14	Property damage liability
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity

The following schedule shows the direct premiums written, by the Company during the examination period, the direct premiums written in New York State, and the percentage, that the New York premiums bear to the countrywide premiums:

<u>Calendar Year</u>	<u>New York State</u>	<u>Total United States</u>	<u>Premiums Written in New York State as a percentage of United States Premiums</u>
1997	\$0	\$0	0.00%
1998	\$0	\$0	0.00%
1999	\$0	\$0	0.00%
2000	\$0	\$0	0.00%
2001	\$0	\$27,991	0.00%

Based on 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 \$1,100,000.

During 2001, the Company began to write automobile liability and physical damage insurance policies in Illinois. The Company's operations were conducted under a managing general agency arrangement by an affiliate, USAgencies Management Services, Inc. This agreement had an effective date of January 1, 2002.

D. Reinsurance

Assumed

The Company does not assume any reinsurance business.

Ceded

The Schedule F data as contained in the Company's filed annual statement was found to accurately reflect its reinsurance transactions.

The examiner reviewed all ceded reinsurance contracts in effect at December 31, 2001. The contracts all contained the required standard clauses including insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

The Company had the following ceded reinsurance program in effect at December 31, 2001:

<u>Type of treaty</u>	<u>Cession</u>
<u>Property / Casualty</u>	
Quota share	75% of Nonstandard Business
100% Authorized	95% of Standard Business
Catastrophe Excess of Loss	3 Layers
100% Authorized	\$200,000 plus 2.5% of each loss occurrence excess of \$2,550,000, per occurrence, limit \$5,100,000 in the aggregate.

Effective November 1, 1999, the Company entered into a quota share reinsurance agreement whereby, 75% of the Company's nonstandard private passenger automobile liability, and 95% of its standard and preferred private passenger automobile liability business are ceded to an authorized insurer. The Department approved this agreement on June 10, 2002, pursuant to the provisions of Section 1308(e)(1)(A) of the New York Insurance Law.

Section 1308 (e)(1)(A) states

“(e) (1) During any period of twelve consecutive months, without the superintendent’s permission:

(A) no domestic insurer, except life, shall by any reinsurance agreement or agreements cede an amount of its insurance on which the total gross reinsurance premiums are more than fifty percent of the unearned premiums on the net amount of its insurance in force at the beginning of such period....”

It is recommended that the Company comply with the provisions of Section 1308(e)(1)(A) of the New York Insurance Law and file with the Department for each year that the Company cedes more than 50% of its beginning unearned premium reserves.

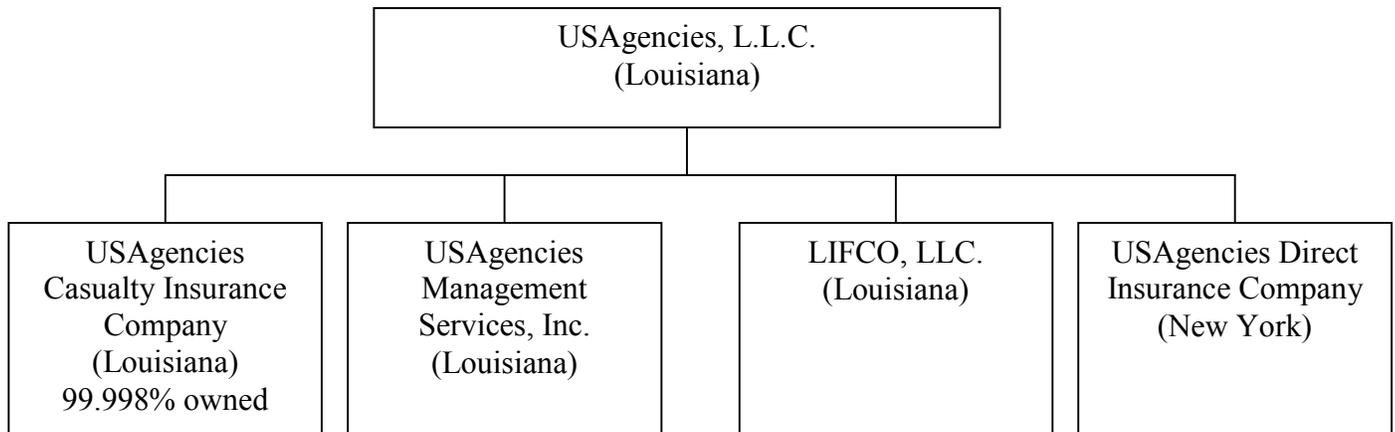
Effective April 1, 2001, the Company is a party to three catastrophe excess of loss reinsurance agreements. Under the terms of these agreements, the Company retains the first \$200,000 of each loss occurrence, plus 2.5% of each loss occurrence in excess of \$200,000. The maximum coverage provided by the agreements is \$2,550,000 for each loss occurrence, not to exceed \$5,100,000 for all loss occurrences.

E. Holding Company System

The Company is a member of the USAgencies Group. The Company is 100% owned by, USAgencies L.L.C., a Louisiana corporation.

A review of the holding company registration statements filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

The following is an organizational chart of the holding company system at December 31, 2001:



At December 31, 2001, the Company was party to the following agreements with other members of its holding company system:

Administrative Services Agreement

The Company submitted an administrative service agreement with USAgencies Management Services, Inc., (“USMS”), a Louisiana Corporation, as part of its acquisition of control of the Company pursuant to Section 1506 of the New York Insurance Law. Under the terms of this agreement, USMS provides the Company management, administrative, claims, policyholder, and information system services. The Department approved the acquisition in April 1999. The administrative service agreement was not activated until Jan 2002.

During our examination it was noted that certain start-up costs relating to product marketing in the State of Illinois were not allocated to the Company based upon the provisions of Department Regulation No. 30, as required by the administrative service agreement between the Company and USMS. The Company was only billed for the rental portion of the total cost.

It is recommended that costs be allocated in accordance with the provisions of the filed service agreement and Department Regulation 30.

Inter-Company Tax Allocation Agreement

Effective May 1, 1999, the Company entered into an inter-company tax allocation agreement with its parent USAgencies, L.L.C. The agreement specified that the Company and parent, along with the other members of the affiliated group, have elected to file a consolidated federal income tax return. The Company shall compute and pay to the parent its federal income tax liability as if it was computed on a

separate return. The agreement was filed with the Department as part of its acquisition of control of the Company pursuant to Section 1506 of the New York Insurance Law.

F. Significant Operating Ratios

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

Net premiums written to surplus as regards policyholders	0%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	4%
Premiums in course of collection to surplus as regards policyholders	0%

All of the above ratios fell within the 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 covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$4,620	236.92%
Other underwriting expenses incurred	287,169	14,726.62
Net underwriting loss	<u>(289,839)</u>	<u>(14,863.54)</u>
Premiums earned	<u>\$1,950</u>	<u>100.00%</u>

G. Abandoned Property Law

Section 1316 of the New York Abandoned Property Law provides that amounts payable to residents of this state from policies 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 Abandoned Property Law.

H. Custodial Service Agreement

During the examination, it was noted that the Company's custodial agreement contained the former name of the Company. Further, it was noted that the Company's commercial checking account at Hibernia National Bank was also in the former name of the Company. It is recommended that the Company change the name on these agreements to reflect its current name.

In addition, it was noted that custodial agreement did not comply with Part 1 IV H Paragraph 2f of the NAIC Examiners Handbook that requires the custodian provide written notification, within three business days of termination of the custodial agreement or withdrawal of 100% of the account assets in any one custody account, to the insurer's domiciliary commissioner.

It is recommended that the custodial agreement be amended to comply with Part 1 IV H Paragraph 2f of the NAIC Examiners Handbook regarding the required custodian service agreement notification provision.

It is also recommended that the Company change the name of the Hibernia Commercial Checking account to reflect its current name.

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 and as reported by the Company:

<u>Assets</u>	Ledger <u>Assets</u>	Assets Not <u>Admitted</u>	Net Admitted <u>Assets</u>
Bonds	\$5,050,668		\$5,050,668
Cash and short-term investments	2,145,164		2,145,164
Reinsurance recoverables on loss and loss adjustment expense payments	4,278		4,278
Federal and foreign income tax recoverable	7,900		7,900
Interest, dividends and real estate income due and accrued	<u>88,213</u>	_____	<u>88,213</u>
Total assets	<u>\$7,296,223</u>	_____	<u>\$7,296,223</u>

Liabilities

Losses		\$ 1,055
Loss adjustment expenses		650
Taxes, licenses and fees (excluding federal and foreign income taxes)		11,261
Unearned premiums		5,830
Payable to parent, subsidiaries and affiliates		<u>250,601</u>
Total liabilities		\$ 269,397

Surplus and Other Funds

Common capital stock	\$2,500,000	
Gross paid in and contributed surplus	500,000	
Unassigned funds (surplus)	<u>4,026,826</u>	
Surplus as regards policyholders		<u>7,026,826</u>
Total liabilities, surplus and other funds		<u>\$7,296,223</u>

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$1,011,188 during the five-year examination period January 1, 1997 through December 31, 2001, detailed as follows:

Underwriting Income

Premiums earned		\$ 1,950
Deductions:		
Losses incurred	\$ 3,747	
Loss adjustment expenses incurred	873	
Other underwriting expenses incurred	<u>287,169</u>	
Total underwriting deductions		<u>291,789</u>
Net underwriting gain or (loss)		\$(289,839)

Investment Income

Net investment income earned	\$1,750,689	
Net realized capital gain	<u>592</u>	
Net investment gain or (loss)		<u>1,751,281</u>
Net income before dividends to policyholders and before federal and foreign income taxes		\$1,461,442
Federal and foreign income taxes incurred		<u>450,254</u>
Net Income		<u>\$1,011,188</u>

C. Capital and Surplus Account

Surplus as regards policyholders per report on examination as of December 31, 1996			\$6,015,638
	Gains in <u>Surplus</u>	Losses in <u>Surplus</u>	
Net income	<u>\$1,011,188</u>	_____	
Net increase (decrease) in surplus			<u>1,011,188</u>
Surplus as regards policyholders per report on examination as of December 31, 2001			<u>\$7,026,826</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$1,705 is the same as reported by the Company as of December 31, 2001. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Companies internal records and in its filed annual statements.

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A. <u>Reinsurance Agreements</u></p> <p>It was strongly recommended that the Company and GRE Insurance Group file all future amendments to its assumed and ceded reinsurance contracts with the Department, pursuant to Article 15 of the New York Insurance Law.</p> <p>The Company has complied with this recommendation.</p>	<p>10-11</p>
<p>B. <u>Holding Company System</u></p> <p>It is recommended that the organization chart filed in Schedule Y of the annual statement include all companies listed by their proper corporate names and remain consistent with the names listed in its holding company filings. During the course of this examination, the Company submitted the corrected listing for the filed 1997 annual statement.</p> <p>The Company has complied with this recommendation.</p> <p>It is recommended that all future holding company reinsurance agreements be filed with the Department pursuant to Section 1505 of the New York Insurance Law. During the course of the examination, the Company filed all current reinsurance agreements within the holding company system.</p> <p>The Company has complied with this recommendation.</p> <p>It is recommended that all administrative and managerial agreements within the holding company system be filed for approval with the Department pursuant to Section 1505 of the New York Insurance Law. During the course of this examination, the Company filed current agreements to be reviewed by the Department.</p> <p>The Company has complied with this recommendation.</p>	<p>11</p> <p>11</p> <p>11-12</p>

ITEMPAGE NO.

It is recommended that the Company develop and maintain methods of allocation of expenses and fees with the parent company that comply with the provisions of Regulation 30 of the New York Insurance Department. Subsequent to this examination, the Company provided a proposed method, which appears to be in compliance.

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The Company has not complied with this recommendation. It was noted in this examination, that the Company's expenses were not allocated according to the provisions of Regulation 30.

C. Abandoned Property Law

It is recommended that the Company file an abandoned property report to the State pursuant to the requirements of Section 1316 of the New York State Abandoned Property Law.

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The Company has complied with this recommendation.

D. Approval of Investments

It is recommended that the board of directors, or a formal committee thereof, approve all investments made by the Company in a timely manner, in accordance with Section 1411(a) of the New York Insurance Law. During the course of the examination, the Company presented documentation, pertaining to investment discussions, which the Company will include in all future investment committee minutes.

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The Company has not complied with this recommendation. It was noted in this examination, that the Company's board of directors minutes did not include a listing of what investments the board approved.

E. Conflict of Interest Statements

It is recommended that all officers, directors, and key employees sign conflict of interest statements during each calendar year.

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The Company has not complied with this recommendation. It was noted in this examination that conflict of interest statements for all the years under review were not available for review.

6. 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 maintain conflict of interest statements for review during examinations.	5
iii. It is recommended that members of the investment and audit committees be identified and named in the board minutes when elected to the committees.	5
iv. It is recommended that the Company attach a listing of the investments approved by the board in either the minutes or as an attachment or exhibit.	5
B. <u>Reinsurance</u>	
It is recommended that the Company comply with the provisions of Section 1308(e)(1)(A) of the New York Insurance Law and file with the Department for each year that the Company cedes more than 50% of its beginning unearned premium reserves.	8
C. <u>Holding Company System</u>	
i. It is recommended that cost be allocated in accordance with the provisions of the filed service agreement and Department Regulation 30.	10
D. <u>Custodian Service Agreements</u>	
i. It is recommended that the Company change the name on its custodial agreement to reflect its current name.	12
ii. It is recommended that the custodial agreement be amended to comply with Part 1 IV H Paragraph 2f of the NAIC Examiners Handbook regarding the required custodian service agreement notification provision.	12
iii. It is recommended that the Company change the name of the Hibernia Commercial Checking account to reflect its current name.	13

Appointment No 21949

**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:

Michael Wyss

as proper person to examine into the affairs of the

US AGENCIES DIRECT INSURANCE COMPANY

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

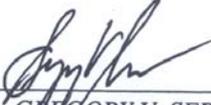
Company

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 4th day of November, 2002





GREGORY V. SERIO
Superintendent of Insurance