REPORT ON EXAMINATION

OF THE

UTICA NATIONAL ASSURANCE COMPANY

AS OF

DECEMBER 31, 1999

| | |
|---|---|
| DATE OF REPORT | MARCH 21, 2001 |
| EXAMINER: | ROBERT W. CLARK |

TABLE OF CONTENTS

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

March 21, 2001

Honorable Neil D. Levin
Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 21530 dated May 2, 2000, attached hereto, I have made an examination into the condition and affairs of the Utica National Assurance Company as of December 31, 1999 and submit the following report thereon.

The examination was conducted at the Company's home office located at 180 Genesee Street, New Hartford, New York 13413.

Wherever the designations "the Company" or "UNAC" appear herein without qualification, they should be understood to indicate the Utica National Assurance Company.

## 1. SCOPE OF EXAMINATION

The prior examination was conducted as of December 31, 1995. This examination covers the four year period from January 1, 1996 through December 31, 1999. 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, 1999, a review of income and disbursements deemed necessary to accomplish such 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 and other insurance
Territory and plan of operations
Growth of Company
Loss experience
Reinsurance
Accounts and records
Market conduct activities

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.

Concurrent examinations were conducted of Utica Mutual Insurance Company ("UMIC"), a New York domestic insurer, and of Graphic Arts Mutual Insurance Company ("GAMIC"), a New York domestic insurer, as of December 31, 1999. These companies are part of a pooling operation with UNAC, as described further in this report in Item 2C, “Reinsurance”. Separate reports on examination have been rendered relative to Utica Mutual Insurance Company and to Graphic Arts Mutual Insurance Company.

A concurrent examination has been conducted of Republic-Franklin Insurance Company (“RFIC”), an Ohio domestic insurer, by the Ohio Insurance Department. Since January 1, 1984, RFIC has been part of the aforementioned pooling operation with the Company.

## 2. DESCRIPTION OF COMPANY

The Company was incorporated on June 7, 1995 under the laws of the State of New York. Operations were conducted under the title, “Graphic Arts Insurance Company” until June 23, 1997, when the present name was adopted.

The Company is 100% owned by Utica Mutual Insurance Company, a New York domiciled insurance company.

In 1998, the Company received a surplus contribution of $10,000,000 from its parent Utica Mutual Insurance Company.

A common management arrangement with UMIC of New Hartford, New York, became effective in 1997. Since 1997, the Company has pooled premiums, losses and expenses with UMIC through a reinsurance pooling agreement which is discussed more fully in Item 2C, “Reinsurance”.

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 thirteen nor more than thirty-one members. As of the examination date, the board of directors was comprised of fourteen members. The board met four times during each calendar year. The directors as of December 31, 1999, were as follows:

| Director | Principal Business Affiliation |
|---|---|
| Thomas P. Bonaros<br>Whitesboro, NY | Vice President and General Counsel,<br>Utica Mutual Insurance Company |
| David C. Cunningham<br>Utica, NY | Senior Vice President,<br>Utica Mutual Insurance Company |
| Kenneth C. Dedrick<br>New Hartford, NY | Senior Vice President,<br>Utica Mutual Insurance Company |
| Robert W. Dicks, Jr.<br>Hew Hartford, NY | Vice President and General Auditor,<br>Utica Mutual Insurance Company |
| George T. Dodd<br>New Hartford, NY | Vice President,<br>Utica Mutual Insurance Company |
| William C. Heston<br>Clinton, NY | Chairman and CEO,<br>Utica National Assurance Company |
| Sharon A. Jachim<br>Whiteboro, NY | Senior Vice President,<br>Utica Mutual Insurance Company |
| Brian P. Lytwynec<br>Ilion, NY | Senior Vice President,<br>Utica Mutual Insurance Company |
| Jeffrey C. Paige<br>Clinton, NY | Senior Vice President,<br>Utica Mutual Insurance Company |
| Clarke W. Peterson<br>New Hartford, NY | Senior Vice President,<br>Utica Mutual Insurance Company |
| Albert A. Ritchie<br>Utica, NY | Senior Vice President,<br>Utica Mutual Insurance Company |
| James D. Robinson<br>New Hartford, NY | President and COO,<br>Utica National Assurance Company |

| Director | Principal Business Affiliation |
|---|---|
| George P. Wardley, III<br>New Woodstock, NY | Secretary,<br>Utica National Assurance Company |
| John R. Zapisek<br>Utica, NY | Treasurer, CFO and EVP,<br>Utica National Assurance Company |

The minutes of all of the 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 82%, with each individual director's attendance being adequate at these meetings.

At December 31, 1999, the principal officers of the Company and their respective titles were as follows:

| Name | Title |
|---|---|
| William C. Heston | Chairman and Chief Executive Officer |
| James D. Robinson | President and Chief Operating Officer |
| George P. Wardley, III | Secretary |
| John R. Zapisek | Treasurer, Chief Financial Officer and Executive Vice President |

B. Territory and Plan of Operation

The Company is authorized to transact business in states of Georgia, Kansas and New York.

The following schedule shows the direct written premiums by calendar year within the examination period, countrywide as well as direct premiums written in New York State and the percentage which the New York premiums bear to the countrywide premiums:

DIRECT PREMIUMS WRITTEN

| Calendar Year | New York State | Total United States | Percentage of U.S. Premiums Written in New York State |
|---|---|---|---|
| 1997 | $294,292 | $294,292 | 100.0% |
| 1998 | $21,123,826 | $34,637,378 | 61.0% |
| 1999 | $37,227,238 | $50,492,324 | 73.7% |

As of December 31, 1999, the Company was authorized to transact the kinds of business defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

| Paragraph | Kind of Business |
|---|---|
| 3 | Accident and health |
| 4 | Fire |
| 5 | Miscellaneous property |
| 6 | Water damage |
| 7 | Burglary and theft |
| 8 | Glass |
| 9 | Boiler and machinery |
| 10 | Elevator |
| 11 | Animal |
| 12 | Collision |
| 13 | Personal injury liability |
| 14 | Property damage liability |
| 15 | Workers' compensation and employers' liability |
| 16 | Fidelity and surety |
| 17 | Credit |
| 19 | Motor vehicle and aircraft |
| 20 | Marine |
| 21 | Marine protection and indemnity |
| 24 | Credit unemployment |
| 26 | Gap insurance |
| 27 | Prize indemnification |
| 28 | Service contract reimbursement |
| 29 | Legal services |

The Company is also licensed to transact such workers' compensation insurance as may be incident to coverages contemplated under paragraphs 20 and 21 of Section 1113(a), including insurances described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69th Congress as amended; 33USC Section 901 et seq. amended).

Based upon the lines of business for which the Company is licensed, and the Company's current capital structure, and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of $9,100,000.

The Company obtains business through 1,261 agents and 143 brokers as of December 31, 1999. Additionally, the Company participates in various pools, associations, syndicates and FAIR plans throughout the United States.

The Company maintains seven full service branch offices and three district claims offices.

C. Reinsurance

The Company assumes reinsurance from affiliates and from non-affiliates as of December 31, 1999.

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

The examiner reviewed all ceded reinsurance contracts in force as of December 31, 1999. These contracts all contained the required standard clauses, including insolvency clauses, meeting the requirements of Section 1308 of the New York Insurance Law.

As of the examination date, the Company had the following excess of loss reinsurance program in place:

| Type of Contract | Cession |
|---|---|
| Property | $9,000,000 excess of $1,000,000 each risk, each loss subject to a loss occurrence limit of $27,000,000; agreement is subject to an annual deductible of $2,500,000. |
| Casualty (5 layers) | $29,000,000 excess of $1,000,000 each occurrence; annual aggregate deductible of $2,500,000. |
| Fidelity | $4,000,000 excess of $1,000,000, each and every loss per insured. |
| Casualty | $5,000,000 excess of $1,000,000 of the liability from directors & officers, condominiums and senior citizen housing; $9,000,000 excess of $1,000,000 of the liability from all other. |

As of the examination date, the Company had the following quota share reinsurance program in place:

| Type of Contract | Cession |
|---|---|
| Casualty | 50% of liability of agricultural workers' compensation and employers' liability business produced by the Kansas Farm Bureau. |
| Auto | 66.67% of $750,000 excess of $250,000 each occurrence for commercial auto produced by its "Spec Pro" division. |
| Errors & Omissions | 50% of $1,000,000 of the liability produced by Graphic Arts Industries. |
| Automatic Umbrella | 90% of $1,000,000 and 100% of $9,000,000 excess of $1,000,000 of the liability produced by Graphic Arts Industries. |
| Boiler and machinery | 100% of $100,000,000 of equipment breakdown liability. |

As of the examination date, the Company had the following additional reinsurance in place:

| Type of Contract | Cession |
|---|---|
| Surety | 45% of $1,000,000, per bond.<br>$3,000,000 excess of $1,000,000, any one principal. |
| Agents' Errors & Omissions | 90% of $5,000,000 per policy, per claim.<br>$5,000,000 excess of $5,000,000 per policy, per claim. |
| Property and casualty | 20% of the liability of the commercial business produced by the Kansas Farm Bureau. |
| Personal Umbrella | 95% of $1,000,000, each occurrence.<br>$4,000,000 excess of $1,000,000, each occurrence. |
| Commercial & School Umbrellas | 50% of $5,000,000, each occurrence.<br>$5,000,000 excess of $5,000,000, each occurrence for commercial; $10,000,000 excess of $5,000,000, each occurrence for school, |

At December 31, 1999, the Company also maintained the following coverage on a per occurrence basis:

| Type of Contract | Cession |
|---|---|
| Property (2 layers) | 95% of $120,000,000 in excess of $30,000,000, each occurrence. |
| Workers' compensation (2 layers) | $50,000,000 excess of $5,000,000, each occurrence. |

As of December 31, 1999, the Company had in force the following automatic facultative excess of loss reinsurance agreement:

| Type of Contract | Cession |
|---|---|
| Property | $30,000,000 excess of $10,000,000 each risk, for schools and condominiums.<br><br>$10,000,000 excess of $10,000,000 each risk, for printers. |

As of December 31, 1999, the Company had in force the following facultative binding authority excess of loss reinsurance agreement:

| Type of Contract | Cession |
|---|---|
| Property | $20,000,000 excess of $20,000,000 each risk, for printers. |
| | $30,000,000 excess of $10,000,000 each risk, all others. |
| Casualty | 90% of $1,000,000, net loss each claim and 100% of $1,000,000 excess of $1,000,000, of the net loss each claim of the employment related practices liability. |

The Company's net retention for both property and casualty business is currently $1,000,000.

The Company cedes by authorized and unauthorized reinsurers. Any balance sheet credit reported by the Company for the unauthorized reinsurance portions of these cessions were secured by bona fide letters of credit.

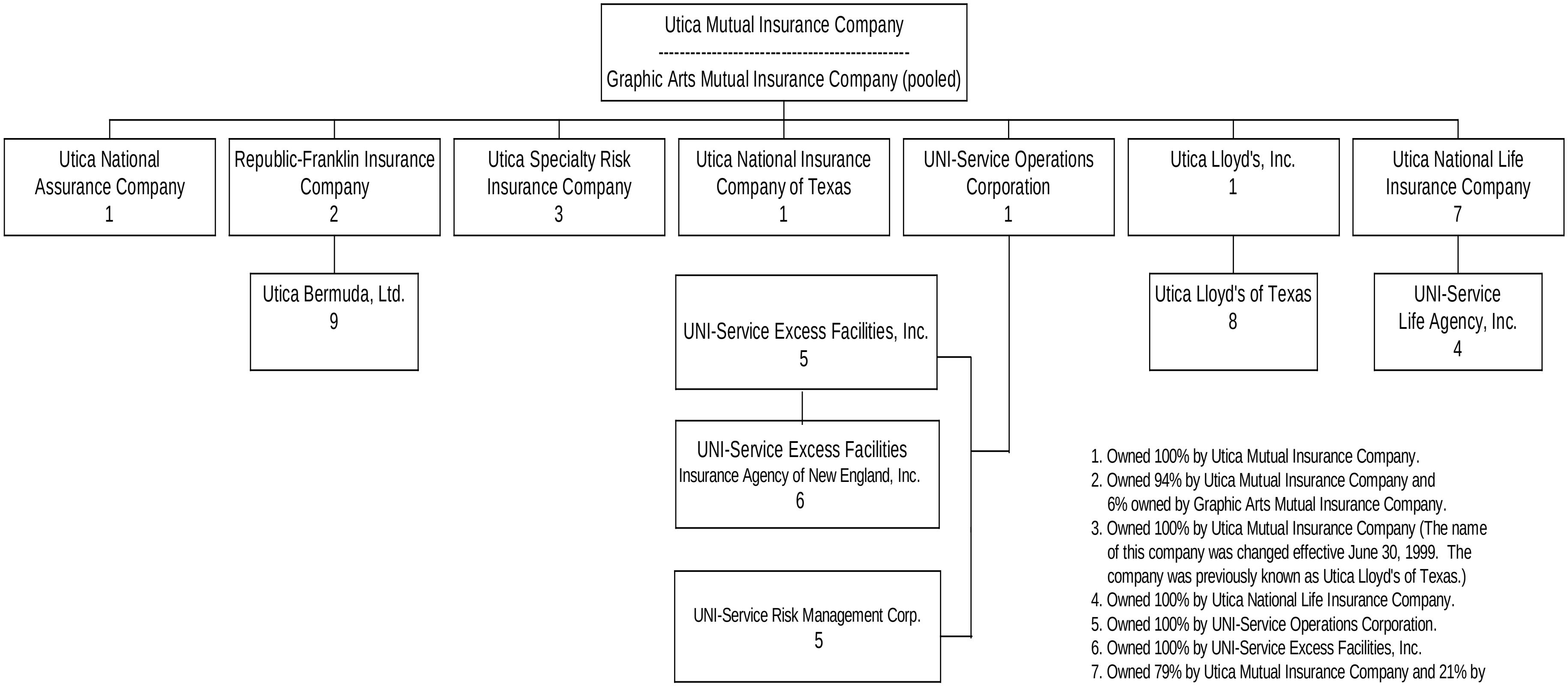
Effective January 1, 1969, Utica Mutual Insurance Company and Graphic Arts Mutual Insurance Company entered into a reinsurance pooling agreement. Effective January 1, 1984, Republic-Franklin Insurance Company was made party to the agreement by amendment thereto. Effective January 1, 1995, Utica National Insurance Company of Texas was made a party to the agreement by amendment. Furthermore, effective January 1, 1997, Utica National Assurance Company was also made party to agreement by amendment thereto. Under this pooling agreement premium income, losses and expenses are shared as follows:

| | |
|---|---|
| Utica Mutual Insurance Company | 89% |
| Graphic Arts Mutual Insurance Company | 5% |
| Republic-Franklin Insurance Company | 3% |
| Utica National Assurance Company | 2% |
| Utica National Insurance Company of Texas | 1% |
| Total | 100% |

D. Affiliated Companies

The Company is not a part of a holding company system as such term is defined in Article 15 of the New York Insurance Law and is therefore not required to make any filings specified by Department Regulation 52.

The Company and its various affiliates comprise the unincorporated entity known as Utica National Insurance Group. The following is an organizational chart outlining the relationship between members as of December 31, 1999:




1. Owned 100% by Utica Mutual Insurance Company.
2. Owned 94% by Utica Mutual Insurance Company and 6% owned by Graphic Arts Mutual Insurance Company.
3. Owned 100% by Utica Mutual Insurance Company (The name of this company was changed effective June 30, 1999. The company was previously known as Utica Lloyd's of Texas.)
4. Owned 100% by Utica National Life Insurance Company.
5. Owned 100% by UNI-Service Operations Corporation.
6. Owned 100% by UNI-Service Excess Facilities, Inc.
7. Owned 79% by Utica Mutual Insurance Company and 21% by Graphic Arts Mutual Insurance Company.
8. A Texas Lloyds association of 12 underwriters under sponsorship of the Utica Mutual Insurance Company.
9. Owned 100% by Republic-Franklin Insurance Company.

Beginning with the taxable year ended December 31, 1983 the Company, Utica National Life Insurance Company, UNI-Service Operations Corporation, Republic-Franklin Insurance Company, Utica National Insurance Company of Texas, Utica Lloyds of Texas, Utica National Assurance Company, UNI-Service Excess Facilities Insurance Agency of New England and UNI-Service Life Agency, Inc. entered into a tax allocation agreement which established a method for allocating the consolidated tax liability, reimbursing payment of tax liability, compensating for use of losses or tax credits and provides for the allocation and payment of refunds arising from a carryback of losses or tax credits from subsequent taxable years.

This agreement was found to be in compliance with Circular Letter No. 33 (1979) promulgated by the New York Insurance Department.

E. Significant Operating Ratios

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

| | |
|---|---|
| Net premiums written in 1999 to Surplus as regards policyholders | 0.70 to 1 |
| Liabilities to liquid assets (loss investment in affiliates) | 66% |
| Premiums in course of collection to Surplus as regards policyholders | 18% |

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 four-year period, January 1, 1995 to December 31, 1999:

| | Amounts | Ratios |
|---|---|---|
| Losses incurred | $20,917,461 | 61.5% |
| Loss adjustment expenses incurred | 4,733,161 | 13.9 |
| Other underwriting expenses incurred | 10,805,949 | 31.8 |
| Net underwriting loss | (2,457,931) | ( 7.2) |
| Premiums earned | $33,998,640 | 100.0% |

F. Abandoned Property Law

During the period covered by this examination, the Company maintained appropriate records of unclaimed funds as required by Section 1316 of the New York Abandoned Property Law. The reports that were required to be filed with the State Comptroller relative to abandoned property were done so in a timely manner.

G. Custodial Agreement

As of December 31, 1999, the Company was a party to a custodial agreement with the Bank of New York for the safekeeping of securities. The agreement was reviewed and found not to be within the framework of the guidelines established by this Department for the contents of such agreement. The deficiencies are described as follows:

1. The agreement did not contain a provision which indicates whether the custodian is covered under a Bankers Blanket Bond of the broadest form available, nor provisions that the Company will be notified in writing at least 60 days in advance of any material change in the form or amount of such bond or termination of the bond.

2. The agreement did not specifically state that the custodian would at all times give the securities held by it the same care that it gives its own property of a similar nature.

3. The agreement did not require the custodian to furnish the insurer (at least quarterly) with a list of such securities showing a complete description of each issue, which shall include the number of shares or par value of bonds so held at the end of such quarter.

Upon learning of the Department's objections the Company revised its custodial agreement to bring itself into compliance with said guidelines.

## H. Investments

At December 31, 1999, the Company's investment portfolio did not meet the investment requirement of Section 1402 of the New York Insurance Law. This section requires every domestic insurer to invest in certain types of securities in an amount equal to or in excess of its minimum capital requirements. The Company's minimum capital is $9,100,000. It is recommended that the Company make changes to its investment portfolio to bring itself into compliance with Section 1402 of the Insurance Law.

Upon learning of the Department's objections, the Company made changes to its portfolio to bring itself into compliance with said guidelines.

# 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, 1999. This statement is the same as the balance sheet filed by the Company:

| Assets | Ledger Assets | Non-Ledger Assets | Not Admitted Assets | Net Admitted Assets |
|---|---|---|---|---|
| Bonds | $38,421,847 | $ | $ | $38,421,847 |
| Preferred stocks | 329,850 | | 13,194 | 316,656 |
| Common stocks | 34,675 | | 14,924 | 19,751 |
| Cash | 598,188 | | | 598,188 |
| Uncollected premiums | 3,944,288 | 7,898 | 132,190 | 3,819,996 |
| Bills receivable, taken for premiums | 14,277 | | 14,277 | |
| Reinsurance recoverable on loss payments | 103,862 | | | 103,862 |
| Electronic data processing equipment | 36,443 | | | 36,443 |
| Interest and dividends due and accrued | | 536,487 | | 536,487 |
| Equities and deposits in pools and associations | 108,592 | | 564 | 108,028 |
| Other assets non-admitted | 517,989 | | 520,782 | (2,793) |
| Aggregate write-in for other than invested assets | 22,336 | | 28,600 | (6,264) |
| Total assets | $44,132,347 | $ 544,385 | $ 724,531 | $43,952,201 |

Liabilities and Surplus

| | | |
|---|---|---|
| Losses | | $14,524,711 |
| Loss adjustment expenses | | 4,411,057 |
| Contingent commissions and other similar charges | | 215,882 |
| Other expenses | | 654,358 |
| Taxes, licenses and fees | | 175,146 |
| Federal and foreign income taxes | | 21,017 |
| Unearned premiums | | 6,041,620 |
| Dividends declared and unpaid | | 201,904 |
| Amounts withheld or retained by company for account of others | | 28,573 |
| Provision for reinsurance | | 2,226 |
| Drafts outstanding | | 525 |
| Payable to parent, subsidiaries and affiliates | | 7,807 |
| Aggregate write-ins for liabilities | | 362,039 |
| Total liabilities | | $26,646,865 |
| Aggregate write-ins for surplus funds | $44,749 | |
| Common capital stock | 3,000,000 | |
| Gross paid in and contributed surplus | 14,200,000 | |
| Unassigned funds | 60,587 | |
| Surplus as regards policyholders | | 17,305,336 |
| Total | | $43,952,201 |

Note: The Internal Revenue Service has completed its audits of the consolidated income tax returns filed on behalf of the Company through tax year 1995. All material adjustments made subsequent to December 31, 1999 and arising from said audits are reflected in the financial statements included in this report. Audits covering tax years 1996 to 1999 have yet to 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 Exhibits

Surplus as regards policyholders increased $10,082,617 for the four year examination period, January 1, 1996 to December 31, 1999 detailed as follows:

Statement of Income

| | | |
|---|---|---|
| **Underwriting Income** | | |
| Premiums earned | | $ 33,998,640 |
| Losses incurred | $20,917,461 | |
| Loss adjustment expenses incurred | 4,733,161 | |
| Other underwriting expenses | 10,805,949 | |
| Total underwriting deductions | | 36,456,571 |
| Net underwriting loss | | $ (2,457,931) |
| **Investment Income** | | |
| Net investment income earned | $ 6,298,990 | |
| Net realized capital gains | 3,679 | |
| Net investment gain | | 6,302,669 |
| **Other Income** | | |
| Agents' balances charged off | $ (80,245) | |
| Finance fee and service charges | 148,970 | |
| Miscellaneous income | (69,864) | |
| Net other income (loss) | | (1,139) |
| Net income before dividends to policyholders and federal income taxes | | $ 3,843,599 |
| Dividends to policyholders | | 955,307 |
| Net income before federal income taxes | | $ 2,888,292 |
| Federal income taxes incurred | | 1,885,342 |
| Net income | | $ 1,002,950 |

Capital and Surplus Account

| | | | |
|---|---|---|---|
| Surplus as regards policyholders, December 31, 1995, per prior report on examination | | | $ 7,222,719 |
| | Gains in Surplus | Losses in Surplus | |
| Net income or loss | $ 1,002,950 | $ | |
| Net unrealized capital losses | | 28,118 | |
| Change in non-admitted assets | | 549,463 | |
| Change in provision for reinsurance | | 113,356 | |
| Surplus paid in | 10,000,000 | | |
| Contingent balance in safety groups | | 160,780 | |
| North Carolina escrow account balance | | 68,616 | |
| Totals | $11,002,950 | $ 920,333 | |
| Net increase in Surplus as regards policyholders | | | 10,082,617 |
| Surplus as regards policyholders, December 31, 1999, per report on examination | | | $ 17,305,336 |

## 4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liabilities of $14,524,711 and $4,411,057 respectively, are the same as the amounts reported by the Company as of the examination date. The examination 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, as verified by the examiners.

## 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, which is the responsibility of the Market Conduct Unit of the Property Bureau of this Department. The general review was directed at practices of the Company in the following major areas:

A) Sales and advertising
B) Underwriting
C) Rating
D) Claims

No unfair practices were encountered.

## 6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The report on organization contained neither comments nor recommendations.

## 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. | Investments | |
| | It is recommended that the Company make changes to its investment portfolio to bring itself into compliance with Section 1402 of the Insurance Law. | 15 |

Respectfully submitted,

/S/
Robert W. Clark
Senior Insurance Examiner

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

ROBERT W. CLARK, 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/
Robert W. Clark
Senior Insurance Examiner

Sworn to before me this ____________ day

of ________________________, 2001

_____________________________________

Notary Public

*Appointment No* 21530

*STATE OF NEW YORK*
*INSURANCE DEPARTMENT*

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

Robert Clark

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

**Utica National Assurance 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* 2nd *day of* May 2000

NEIL D. LEVIN
*Superintendent of Insurance*