

REPORT ON EXAMINATION

OF

LEATHERSTOCKING COOPERATIVE INSURANCE COMPANY

AS OF

DECEMBER 31, 2016

DATE OF REPORT

MARCH 30, 2018

EXAMINER

LEE PROWELL

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NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Maria T. Vullo
Superintendent

March 30, 2018

Honorable Maria T. Vullo
Superintendent
New York State Department of Financial Services
New York, New York 10004

Madam:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 31680 dated October 27, 2017, attached hereto, I have made an examination into the condition and affairs of Leatherstocking Cooperative Insurance Company as of December 31, 2016, and submit the following report thereon.

Wherever the designation “the Company” appears herein without qualification, it should be understood to indicate Leatherstocking Cooperative Insurance Company.

Wherever the term “Department” appears herein without qualification, it should be understood to mean the New York State Department of Financial Services.

The examination was conducted at the Company’s home office located at 4313 County Highway 11, Cooperstown, New York 13326.

1. SCOPE OF EXAMINATION

The Department has performed an examination of the Company, a single-state insurer. The previous examination was conducted as of December 31, 2011. This examination covered the five-year period from January 1, 2012 through December 31, 2016. Transactions occurring subsequent to this period were reviewed when deemed appropriate by the examiner.

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”), which requires that we plan and perform the examination to evaluate the financial condition and identify current and prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. This examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with New York laws, statutory accounting principles, and annual statement instructions.

This examination report includes, but is not limited to, the following:

- Company history
- Management and control
- Territory and plan of operation
- Reinsurance
- Loss review and analysis
- Financial statement presentation
- Summary of recommendations

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

2. DESCRIPTION OF COMPANY

The Company was incorporated under the laws of the State of New York on June 27, 1887 as Otsego County Farmers' Co-operative Fire Insurance Company and commenced business on the same date. The current name was adopted on October 1, 1990. The Company is not a member of any affiliated group or holding company system.

A. Corporate Governance

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. The board meets annually immediately after the annual meeting of the policyholders of the Company. As of December 31, 2016, the board of directors was comprised of the following twelve members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Wayne D. Benjamin Morris, New York	Retired
Edward J. Ciasch Rochester, New York	Retired
Jeffery T. Coffin Maryland, New York	Consultant
Mary J. Conroe Morris, New York	Vice President, Leatherstocking Cooperative Insurance Company
Peter L. Craig Hartwick, New York	Retired
Nathan R. Fenno Cooperstown, New York	President, Delaware Otsego Corp. (Cooperstown Railroad)
James S. Foote Oneonta, New York	Director of Technology, Otsego Electric Corporation
Philip A. Lewis Cooperstown, New York	President, Leatherstocking Cooperative Insurance Company

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Margaret S. Maguire Oneonta, New York	Retired
Kim K. Muller Oneonta, New York	Director of Eastern Stream Center on Resources and Training, Research Foundation for State University of New York
Carol B. Ronovech Cherry Valley, New York	Independent Certified Public Accountant
Lynn J. Woodard South New Berlin, New York	Retired

A review of the minutes of the board of directors' meeting held during the examination period indicated that the meetings were well attended and each board member had an acceptable record of attendance.

As of December 31, 2016, the principal officers of the Company were:

<u>Name</u>	<u>Title</u>
Philip A. Lewis	President
Amy L. Lyon	Treasurer and Secretary
Mary Jane Conroe	Vice President

B. Territory and Plan of Operation

As of December 31, 2016, the Company was licensed to write business in all counties of New York State except Bronx, Kings, New York, Queens, and Richmond.

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
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability (excluding Workers' Compensation)
19	Motor vehicle and aircraft physical damage (excluding aircraft physical damage)
20	Marine and inland marine (inland marine only)

The Company was also licensed to accept and cede reinsurance as provided for in Section 6606 of the Insurance Law of the State of New York.

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 \$100,000.

The following schedule shows the direct premium written by the Company for the period under examination:

<u>Calendar Year</u>	<u>Direct Premiums Written</u>
2012	\$ 8,011,750
2013	\$ 9,628,442
2014	\$11,798,736
2015	\$14,958,698
2016	\$18,034,295

The Company did not assume any business during the period under examination.

The major lines of business written by the Company are commercial multi-peril, homeowners multi-peril and fire which accounted for approximately 47%, 34%, and 18%, respectively, of the 2016 direct written premiums. The Company writes business exclusively through approximately 147 independent agents located throughout upstate New York.

C. Reinsurance Ceded

The Company has structured its ceded reinsurance program as follows:

<u>Type of treaty</u>	<u>Cession</u>
<u>Property Excess of Loss</u> 2 layers	\$825,000 excess of \$175,000 ultimate net loss, each loss, each risk, subject to a limit of liability of \$1,150,000 and \$500,000 each loss occurrence on the first layer and second layer, respectively.
<u>Casualty Excess of Loss</u> 2 layers	\$900,000 excess of \$100,000 ultimate net loss, each loss occurrence.
<u>Casualty – Liquor Liability Excess of Loss</u> 1 layer	\$400,000 excess of \$100,000 ultimate net loss, each loss occurrence as respects casualty policies with liquor liability limits of \$1,000,000 only.
<u>Casualty and Property Combined</u> 1 layer	In the event of a loss occurrence involving one or more property policy and one or more casualty policy: \$100,000 excess of \$175,000 each loss occurrence.
<u>Property Catastrophe Excess of Loss</u> 2 layers	\$1,525,000 excess of \$475,000 ultimate net loss, each loss occurrence.
<u>Casualty Clash Excess of Loss</u> 1 layer	\$1,000,000 excess of \$1,000,000 ultimate net loss, each loss occurrence. With respect to workers compensation required by subsection (j) of Section 3420 of New York Insurance Laws, no claim shall be made unless the Company shall have first sustained an ultimate net loss in excess of \$2,000,000. The Reinsurer shall then reimburse the Company for the whole of such excess.
<u>Equipment Breakdown</u> <u>100% Quota Share</u>	100% of the Company's net retained liability subject to a limit of \$5,000,000 on any one risk.

Facultative property coverage is maintained whereby maximum cession is limited to \$1,000,000 on any one risk, subject to a minimum net retention of \$200,000.

Facultative casualty coverage is also maintained in excess of \$1,000,000 each loss occurrence, each policy, subject to a limit of liability of \$1,000,000 each loss occurrence, each policy.

Since the previous examination, the Company's retention has increased from \$120,000 to \$175,000 on property business and from \$80,000 to \$100,000 on casualty business. All reinsurance was ceded to authorized/accredited reinsurers.

All significant ceded reinsurance agreements in effect as of the examination date were reviewed and found to contain the required clauses, including an insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law.

Examination review found that the Schedule F data reported by the Company in its filed annual statement accurately reflected its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62R. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's President and Treasurer pursuant to the NAIC annual statement instructions. Additionally, examination review indicated that the Company was not a party to any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in SSAP No. 62R.

D. Significant Operating Ratios

The Company's operating ratios, computed as of December 31, 2016, fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

<u>Operating Ratios</u>	<u>Result</u>
Net premiums written to policyholders' surplus	84%
Adjusted liabilities to liquid assets	44%
Two-year overall operating	70%

Underwriting Ratios

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>Ratio</u>
Losses and loss adjustment expenses incurred	\$22,481,573	44.91%
Other underwriting expenses incurred	16,955,621	33.87%
Net underwriting gain	<u>10,619,188</u>	<u>21.22%</u>
Premiums earned	<u>\$50,056,382</u>	<u>100.00%</u>

The Company's reported risk based capital score ("RBC") was 1,900.9% at 12/31/2016. The RBC is a measure of the minimum amount of capital appropriate for a reporting entity to support its overall business operations in consideration of its size and risk profile. An RBC of 200 or below can result in regulatory action. There were no financial adjustments in this report that impacted the company's RBC score.

E. Accounts and Records

i. Fidelity Insurance Coverage

The Company did not maintain the minimum fidelity insurance coverage in accordance with the NAIC Financial Condition Examiners Handbook.

It is recommended that the Company obtain adequate fidelity bond coverage commensurate with its exposure.

ii. Conflict of Interest Statements

The Company responded "yes" to General Interrogatory, question 18 of the 2016 filed annual statement indicating that there is an established procedure for disclosure to its board of any material interest or affiliation on the part of its officers and directors or responsible employees that is in conflict with the official duties of such person. However, upon review the examiner noted that the Company has a contract with Connexion Insurance Agency, LLC, which is owned by the Company's President and Vice President who are also directors of the Company. This information was not disclosed on their signed conflict of interest statements.

It is recommended that the Company require its officers, directors, or key employees to complete and sign, on an annual basis, a conflict of interest statement, wherein the signer would disclose any potential conflicts of interest, and that the Company retain such signed statements in its files.

iii. Custodian Agreement

The Company's custodian agreement with NBT Bank does not include any of the NAIC required provisions as stated in Section 1 – Part (3)(F) of the NAIC Financial Condition Examiners Handbook - general examination guidance for custodial or safe keeping agreements.

It is recommended that the Company comply with the NAIC requirements as stated in Section 1 – Part (3)(F) of the NAIC Financial Condition Examiners Handbook and include the NAIC required provisions in the Company's custodian agreement(s).

Subsequent to the examination date, the Company prepared an addendum to the custodian agreement, effective January 4, 2018, that includes the NAIC required provisions.

iv. Loss Data Reconciliation

The Company does not perform a reconciliation of loss data from the underlying actuarial report to the general ledger nor to the annual statement's Schedule P.

It is recommended that the Company perform a reconciliation of loss data from the underlying actuarial report to the general ledger and to the annual statement's Schedule P.

v. Compliance with Department Regulation 152

The Company's management stated that the fixed securities reported on the financial statements are rated/designated by Moody's and/or Standard and Poor's. However, the Company was unable to provide documentation to support the fixed securities reported on the financial statements as of December 31, 2015 and 2016 which were rated/designated by Moody's, Standard and Poor's, or by any other nationally recognized statistical rating organizations.

Department Regulation 152 states in part:

“(a) In addition to any other requirement contained in Insurance Law Section 325, any other Section of the Insurance Law or other law, or any other provision of this Title, every insurer shall maintain its claims, rating, underwriting, marketing, complaint, financial, and producer licensing records, and such other records subject to examination by the superintendent, in accordance with the provisions of this Part.

(b) Except as otherwise required by law or regulation, an insurer shall maintain:

(7) A financial record necessary to verify the financial condition of an insurer, including ledgers, journals, trial balances, annual and quarterly statement workpapers, evidence of asset ownership, and source documents, for six calendar years from its creation or until after the filing of the report on examination in which the record was subject to review, whichever is longer.”

It is recommended that the Company maintain records in compliance with the record retention requirements prescribed in Department Regulation 152.

2. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2016 as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$24,350,343		\$24,350,343
Common stocks (stocks)	5,082,926		5,082,926
Properties occupied by the company	349,292		349,292
Properties held for the production of income	158,087		158,087
Cash, cash equivalents and short-term investments	1,826,291		1,826,291
Other invested assets	566,034		566,034
Investment income due and accrued	213,640		213,640
Uncollected premiums and agents' balances in the course of collection	563,798	\$ 1,697	562,101
Deferred premiums, agents' balances and installments booked but deferred and not yet due	3,288,481		3,288,481
Amounts recoverable from reinsurers	35,493		35,493
Other amounts receivable under reinsurance contracts	20,379		20,379
Current federal and foreign income tax recoverable and interest thereon	146,725		146,725
Net deferred tax asset	113,680		113,680
Electronic data processing equipment and software	3,135		3,135
Furniture and equipment, including health care delivery assets	45,511	45,511	0
Aggregate write-ins for other than invested assets	<u>(6,856)</u>	<u>0</u>	<u>(6,856)</u>
Total assets	<u>\$36,756,959</u>	<u>\$47,208</u>	<u>\$36,709,751</u>

Liabilities, Surplus and Other FundsLiabilities

Losses and loss adjustment expenses		\$ 6,378,315
Commissions payable, contingent commissions and other similar charges		776,759
Other expenses (excluding taxes, licenses and fees)		207,036
Unearned premiums		9,483,035
Advance premium		177,876
Ceded reinsurance premiums payable (net of ceding commissions)		88,608
Amounts withheld or retained by company for account of others		16,643
Payable for securities		<u>475</u>
Total liabilities		\$17,128,747

Surplus and Other Funds

Unassigned funds (surplus)	\$19,481,004	
Required surplus	<u>100,000</u>	
Surplus as regards policyholders		<u>19,581,004</u>
Total liabilities, surplus and other funds		<u>\$36,709,751</u>

Note: The Internal Revenue Service has not audited the Company's tax returns covering tax years 2012 through 2016 for the Company. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Statement of Income

The net income for the examination period as reported by the Company was \$9,023,486 as detailed below:

Underwriting Income

Premiums earned		\$50,056,382
Deductions:		
Losses and loss adjustment expenses incurred	\$22,481,573	
Other underwriting expenses incurred	<u>16,955,621</u>	
Total underwriting deductions		<u>39,437,194</u>
Net underwriting gain		\$10,619,188

Investment Income

Net investment income earned	\$ 2,863,425	
Net realized capital gain	<u>81,138</u>	
Net investment gain		2,944,563

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (122,813)	
Finance and service charges not included in premiums	330,784	
Aggregate write-ins for miscellaneous income	<u>3,198</u>	
Total other income		<u>211,169</u>
Net income to policyholders and before federal and foreign income taxes		\$13,774,920
Federal and foreign income taxes incurred		<u>4,751,434</u>
Net income		\$ <u>9,023,486</u>

C. Capital and Surplus

Surplus as regards policyholders increased \$10,602,310 during the five-year examination period January 1, 2012 through December 31, 2016 as reported by the Company, detailed as follows:

Surplus as regards policyholders as reported by the Company as of December 31, 2011		\$ 8,978,694
	<u>Gains in Surplus</u>	
Net income	\$ 9,023,486	
Net unrealized capital gains	782,459	
Change in net deferred income tax	446,328	
Change in non-admitted assets	<u>350,037</u>	
Net increase in surplus		<u>10,602,310</u>
Surplus as regards policyholders as reported by the Company as of December 31, 2016		<u>\$19,581,004</u>

No adjustment was made to surplus as a result of this examination.

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$6,378,315 is the same as reported by the Company as of December 31, 2016. The examination analysis of the loss and loss adjustment expense reserves was conducted in accordance with generally accepted actuarial principles and statutory accounting principles, including the NAIC Accounting Practices & Procedures Manual, Statement of Statutory Accounting Principle No. 55 (“SSAP No. 55”). Commercial multi-peril and homeowners’ multiperil lines of business made up approximately 47% and 41%, respectively, of the reported reserves as of December 31, 2016.

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Risk Management and Internal Controls</u>	
i. It was recommended that the Company strengthen its IT controls.	8
The Company has complied with this recommendation.	
ii. It was recommended that the Company fully document each risk mitigation control in order for examiners to document and test the existence of controls in place at the Company.	8
The Company has complied with this recommendation.	

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Accounts and Records</u>	
i. It is recommended that the Company obtain adequate fidelity bond coverage commensurate with its exposure.	8
ii. It is recommended that the Company require its officers, directors, or key employees to complete and sign, on an annual basis, a conflict of interest statement, wherein the signer would disclose any potential conflicts of interest, and that the Company retain such signed statements in its files.	8
iii. It is recommended that the Company comply with the NAIC requirements as stated in Section 1 – Part (3)(F) of the NAIC Financial Condition Examiners Handbook and include the NAIC required provisions in the Company’s custodian agreement(s).	9
<p>Subsequent to the examination date, the Company prepared an addendum to the custodian agreement, effective January 4, 2018, that includes the NAIC required provisions.</p>	
iv. It is recommended that the Company perform a reconciliation of loss data from the underlying actuarial reports to the general ledger and or the Schedule P.	9
v. It is recommended that the Company maintain records in compliance with the record retention standards prescribed in New York State Regulation 152.	9

Respectfully submitted,

_____/S/
Lee Prowell
Senior Insurance Examiner

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

Lee Prowell, being duly sworn, deposes and says that the foregoing report, subscribed by him, is true to the best of his knowledge and belief.

_____/S/
Lee Prowell

Subscribed and sworn to before me
this _____ day of _____, 2019.

NEW YORK STATE

DEPARTMENT OF FINANCIAL SERVICES

I, Maria T. Vullo, Superintendent of Financial Services of the State of New York, pursuant to the provisions of the Financial Services Law and the Insurance Law, do hereby appoint:

Lee Prowell

as a proper person to examine the affairs of the
Leatherstocking Cooperative Insurance Company
and to make a report to me in writing of the condition of said
COMPANY

with such other information as he shall deem requisite.

In Witness Whereof, I have hereunto subscribed by name
and affixed the official Seal of the Department
at the City of New York

this 27th day of October, 2017

MARIA T. VULLO
Superintendent of Financial Services



By:

Joan M. Riddell

Joan Riddell
Deputy Bureau Chief