

REPORT ON EXAMINATION

OF

MERCHANTS PREFERRED INSURANCE COMPANY

AS OF

DECEMBER 31, 2018

DATE OF REPORT

AUGUST 29, 2019

EXAMINER

WAYNE LONGMORE

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## Department of Financial Services

**ANDREW M. CUOMO**  
Governor

**LINDA A. LACEWELL**  
Superintendent

August 29, 2019

Honorable Linda A. Lacewell  
Superintendent  
New York State Department of Financial Services  
Albany, New York 12257

Madam:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 31856 dated January 8, 2019, attached hereto, I have made an examination into the condition and affairs of Merchants Preferred Insurance Company as of December 31, 2018, and submit the following report thereon.

Wherever the designation “the Company” or “MPIC” appears herein, without qualification, it should be understood to indicate Merchants Preferred 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 250 Main Street, Buffalo, New York, 14202.

## 1. SCOPE OF EXAMINATION

The Department has performed an examination of the Company, a multi-state insurer. The previous examination was conducted as of December 31, 2013. This examination covered the five-year period from January 1, 2014, through December 31, 2018. Transactions occurring subsequent to this period were reviewed when deemed appropriate by the examiner.

New York was the lead state of the Merchants Mutual Group. The examination was performed concurrently with the examinations of the following insurers: Merchants Mutual Insurance Company (“MMIC”), and Merchants National Insurance Company (“MNIC”). New Hampshire participated in this examination.

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners 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
- Affiliated group description
- Financial statement presentation
- Loss review and analysis
- Summary of recommendations

A review was also made to ascertain what action was taken by the Company regarding the recommendation 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

Merchants Preferred Insurance Company was incorporated under the laws of the State of New York on September 29, 2006. It became licensed on February 26, 2007 and commenced business on the same date.

### 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 seven nor more than fifteen persons. The board meets at least four times during each calendar year. At December 31, 2018, the board of directors was comprised of the following eleven members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Gary Martin Brost Chautauqua, New York	Chairman and Chief Executive Officer, Strategic Investments & Holdings, Inc.
Randall Livingston Clark Vero Beach, Florida	Chairman, Dunn Tire Corporation, LLC
Linda Petri Duch Naples, Florida	President, Partners for Business
John Melville Foehl, Jr. Cheshire, Connecticut	Retired
Muriel Atkinson Howard, PhD Upper Marlboro, Maryland	President, American Association of State Colleges and Universities
Brian Jeffrey Lipke Derby, New York	Retired
Nora Kathleen McGuire Tonawanda, New York	Senior Vice President and Chief Marketing Officer, Independent Health Association
Michael Joseph Murray Hamburg, New York	Retired

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Edward Galbraith Wright Hamburg, New York	President and Chief Executive Officer, W.J. Cox Associates, Inc.
Robert Michael Zak Buffalo, New York	President and Chief Executive Officer, Merchants Mutual Insurance Company
Ronald Keith Zoeller Orchard Park, New York	Chief Executive Officer, Azeros Healthcare, LLC

As of December 31, 2018, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Robert Michael Zak	President and Chief Executive Officer
Charles Edward Makey III	Senior Vice President, Insurance Operations
Shaddon Cale McKnight*	Senior Vice President, Underwriting, Product Development
Thomas Alan Meyers**	Senior Vice President, Chief Financial Officer and Treasurer
Daniel John Bierbrauer, Jr	Vice President, Sales and Marketing
Kenneth Patrick Carter	Vice President, Claims Operations
Kelly Julius	Vice President, Human Resources
Salvatore LaDuca III*	Vice President, Product Management & Actuarial

\*Shaddon McKnight resigned from the position of Senior Vice President, Underwriting, Product Development effective July 12, 2019 and was replaced by Salvatore LaDuca III as Senior Vice President, Underwriting, Product Development and Actuarial that same date.

\*\*Thomas Meyers retired from the positions of Senior Vice President, Chief Financial Officer and Treasurer effective March 29, 2019 and Christine Schmitt was appointed to replace Mr. Meyers as Senior Vice President, Chief Financial Officer, effective April 1, 2019.

B. Territory and Plan of Operation

As of December 31, 2018, the Company was licensed to write business in 13 states.

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>
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 physical damage
20	Marine and inland marine
21	Marine protection and indemnity
26 (A)(B)(C)(D)	Gap

The Company was also authorized to write such workers' compensation insurance as may be incidental to coverages contemplated under paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law.

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 \$6,400,000.

The following schedule shows the direct and assumed premiums written by the Company for the period under examination:

<u>Calendar Year</u>	<u>Direct Premiums</u>	<u>Assumed Premiums</u>	<u>Total Gross Premiums</u>
2014	\$72,974,973	\$22,294,324	\$ 95,269,297
2015	\$67,319,581	\$21,994,549	\$ 89,314,130
2016	\$65,370,622	\$21,884,897	\$ 87,255,519
2017	\$72,113,706	\$23,005,898	\$ 95,119,604
2018	\$78,203,258	\$25,458,527	\$103,661,785

The Company's predominant lines of business are commercial auto liability, commercial multiple peril and auto physical damage, which accounted for 32%, 17% and 16%, respectively of the 2018 direct written premiums. Most of the Company's direct written premiums (approximately 90%) is written in New York (74%), New Jersey (11%) and Massachusetts (5%).

Approximately 96% of the Company's assumed premiums written was derived from its participation in an intercompany pooling agreement between the Company and its affiliates, MNIC and MMIC, as noted below. The remaining 4% of assumed premiums reflects the Company's participation in various state-mandated risk pools.

The Company's products are sold through more than 750 independent insurance agents operating out of 1,100 locations.

Due to the pooling and reinsurance agreements (described in section 2C of this report), the net exposure of the Company is significantly different than its direct and assumed exposure.

#### C. Reinsurance Ceded

##### Intercompany Pooling Agreements

Effective July 1, 2007, MMIC, MNIC and the Company are parties to an Amended and Restated Pooling Agreement ("Merchants Pooling Agreement"), whereby the three companies agree to pool their insurance business. Under the terms of the agreement, MNIC and the Company cede to MMIC all their premiums, losses and underwriting expenses and then assume from MMIC a percentage of the pooled business. The pooling percentages for MMIC, MNIC and the Company as of December 31, 2018 were 70%, 20% and 10%, respectively.

## Ceded Reinsurance Program

The Company has structured its ceded reinsurance program as follows:

<u>Type of Treaty</u>	<u>Cession</u>
<u>Property Per Risk Excess of Loss (2 layers)</u>	\$6,500,000 in excess of \$500,000.
<u>Property Catastrophe Excess of Loss (1st layer)</u>	\$5,000,000 in excess of \$5,000,000 ultimate net loss, any one loss occurrence.
Layers 2 through 4	\$85,000,000 in excess of \$10,000,000 ultimate net loss, any one occurrence.
<u>Casualty Excess of Loss (3 layers)</u>	\$9,250,000 in excess of \$750,000.
<u>Section B – Combined Property and Casualty</u>	\$500,000 in excess of \$750,000 ultimate net loss in any one combined occurrence.
<u>Workers’ Compensation Catastrophe Excess of Loss</u>	\$15,000,000 in excess of \$10,000,000 ultimate net loss, any one loss occurrence.
<u>Personal Umbrella Quota Share and Excess of Loss</u>	75% quota share of the first \$1,000,000 each occurrence, and 100% of the difference, if any, between the policy limit and the first \$1,000,000 each occurrence.
<u>Commercial Umbrella Quota share and Excess of Loss</u>	75% quota share of the first \$1,000,000 each occurrence, and 100% of the difference, if any, between the policy limit and the first \$1,000,000 each occurrence.
<u>Umbrella Excess Liability-Greene (2 layers)</u>	100% of \$1,000,000 in net liability, each policy, each occurrence.
Layer 1: 85% placed	
Layer 2	\$9,000,000 excess of \$1,000,000 of the net liability, each policy, each occurrence.
<u>Casualty Quota Share</u>	100% of the net liability, limited to \$2,000,000 or \$4,000,000 each policy, each occurrence or claim made as respects General Liability business or Products and Completed operations business, respectively. \$4,000,000 aggregate limit each policy.
75% placed	

In addition to its treaty reinsurance program, the Company also obtained facultative reinsurance coverage, in addition to its basic coverage for property losses. The facultative treaty will provide property coverage of \$8 million excess of the Company’s \$7 million retention each risk.

Most of the Company's business was ceded to authorized reinsurers, and the amount in cessions to authorized companies has increased since the last exam.

It is the Company's policy to obtain the appropriate collateral for its cessions to unauthorized and certified 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 material reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in the NAIC Accounting Practices and Procedures Manual, Statement of Statutory Accounting Principles ("SSAP") No. 62R. Representations were supported by an attestation from the Company's President and Chief Financial Officer. 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.

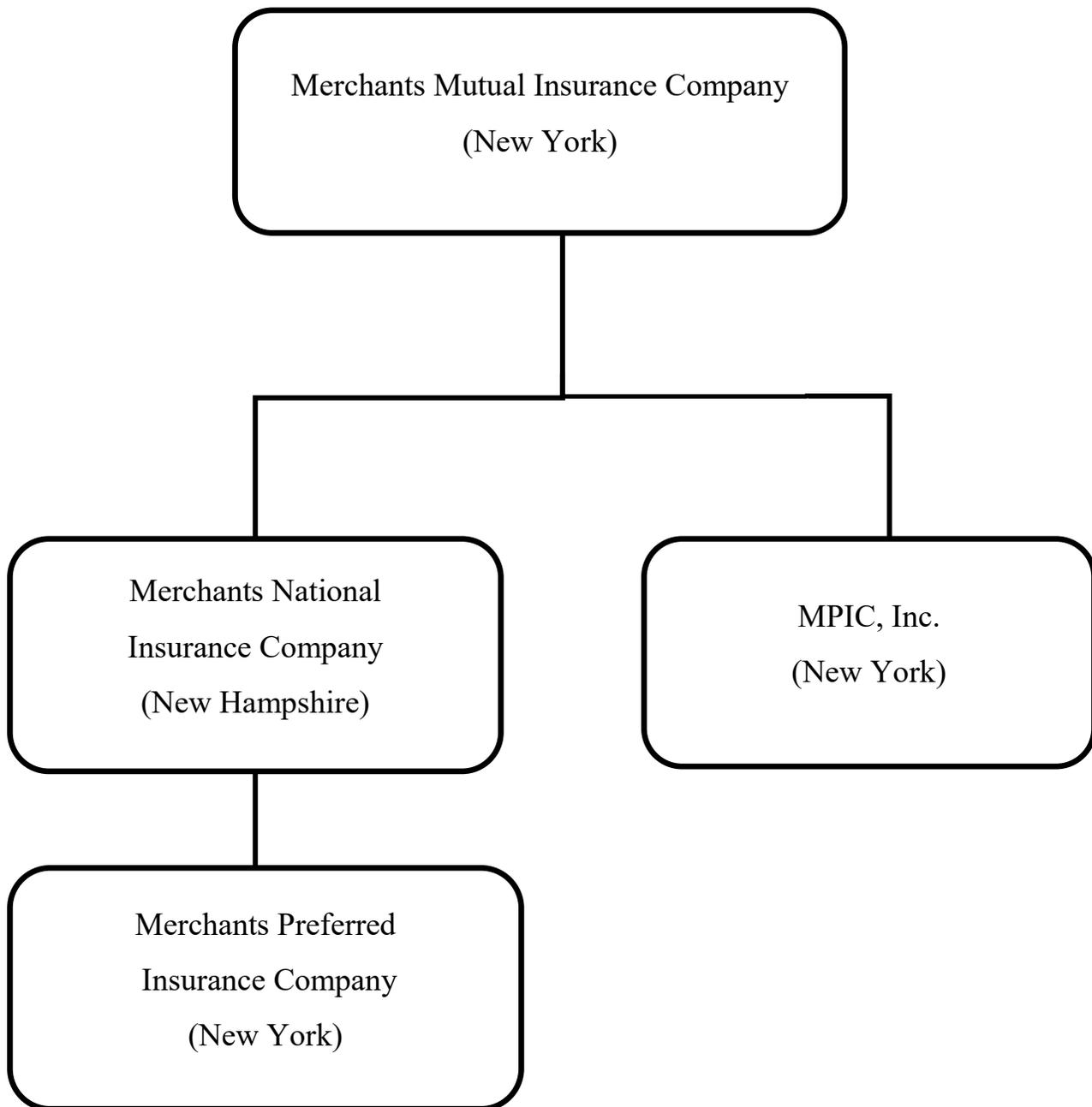
#### D. Affiliated Group

The Company is a member of the Merchants Mutual Group ("Group"). The Company is wholly-owned by MNIC, a New Hampshire domiciled property and casualty insurance company, which is wholly-owned by MMIC. MMIC also owns MPIC, Inc., a general-purpose New York State business corporation whose primary asset is the office building that is leased to MMIC. The Group offers property and casualty insurance to individuals and small to medium-sized businesses throughout the Northeast and North Central United States. During 2018, the Group completed the run-off of personal lines in all states except for New York, where it continues to write personal lines business.

Because the Company's ultimate parent is a mutual insurer, the Company is not subject to the provisions of Article 15 of the New York Insurance Law. However, pursuant to the provisions of Circular Letter No. 10 (2010), the Company is required to submit to this Department, within 120 days following the close of the ultimate parent company's fiscal year, a copy of the NAIC insurance holding company system

annual registration statement. The Company made the required filings on a timely basis during the period covered by this examination.

The following is an unabridged chart of the Company and its affiliated entities at December 31, 2018:



At December 31, 2018, the Company was party to the following agreements with other affiliated entities:

Management Agreement

Effective October 1, 2011, the Company entered into a Second Amended and Restated Management Agreement with MPIC and MNIC. Pursuant to the terms of the agreement, MMIC agreed to provide the Company and MNIC with facilities, management and personnel required to operate their business. In 2018, the Company paid \$2,366,923 to the MMIC, in accordance with the terms of the agreement.

Tax Sharing Agreement

Effective January 1, 2007, the Company entered into an Amended and Restated Tax Sharing Agreement with its affiliates. Pursuant to the terms of the agreement, the parties file a consolidated federal income tax return. The agreement provides that the Company's tax liability on a consolidated basis will not exceed the liability had it filed its tax return on a stand-alone basis. This agreement was filed with the Department.

E. Significant Ratios

The Company's operating ratios, computed as of December 31, 2018, fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the NAIC.

<u>Operating ratios</u>	<u>Result</u>
Net premiums written to policyholders' surplus	75%
Adjusted liabilities to liquid assets	59%
Two-year overall operating	84%

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>Ratios</u>
Losses and loss adjustment expenses incurred	\$ 65,979,108	61.02%
Other underwriting expenses incurred	38,215,502	35.34
Net underwriting gain	<u>3,934,572</u>	<u>3.64</u>
Premiums earned	<u>\$108,129,182</u>	<u>100.00%</u>

The Company's reported risk-based capital ("RBC") score was 954% as of December 31, 2018. 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.

### 3. FINANCIAL STATEMENTS

#### A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2018, as reported by the Company.

#### Assets

	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$60,633,935		\$60,633,935
Preferred stocks (stocks)	1,019,705		1,019,705
Common stocks (stocks)	5,182,006		5,182,006
Cash, cash equivalents and short-term investments	2,060,221		2,060,221
Investment income due and accrued	369,611		369,611
Uncollected premiums and agents' balances in the course of collection	1,280,554	\$ 77,245	1,203,309
Deferred premiums, agents' balances and installments booked but deferred and not yet due	8,078,643		8,078,643
Amounts recoverable from reinsurers	197,023		197,023
Net deferred tax asset	1,538,000	191,000	1,347,000
Receivables from parent, subsidiaries and affiliates	1,472,740		1,472,740
Equities and deposits in pools and associations	339,262		339,262
Prepaid expenses	<u>163,219</u>	<u>163,219</u>	<u>0</u>
Total assets	<u>\$82,334,919</u>	<u>\$431,464</u>	<u>\$81,903,455</u>

Liabilities, Surplus and Other FundsLiabilities

Losses and loss adjustment expenses	\$27,249,579
Commissions payable, contingent commissions and other similar charges	2,679,195
Other expenses (excluding taxes, licenses and fees)	3,392,298
Taxes, licenses and fees (excluding federal and foreign income taxes)	740,245
Current federal and foreign income taxes	864,000
Unearned premiums	12,717,601
Advance premium	114,929
Ceded reinsurance premiums payable (net of ceding commissions)	1,058,105
Funds held by company under reinsurance treaties	11,572
Amounts withheld or retained by company for account of others	<u>254,765</u>
Total liabilities	\$49,082,289

Surplus and Other Funds

Common capital stock	\$ 4,200,000
Gross paid in and contributed surplus	20,800,000
Unassigned funds (surplus)	<u>7,821,167</u>
Surplus as regards policyholders	<u>32,821,167</u>
Total liabilities, surplus and other funds	<u>\$81,903,456</u>

Note: The Internal Revenue Service did not audit any of the Company's federal income tax returns during the period under examination. 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 \$8,883,255 as detailed below:

Underwriting Income

Premiums earned		\$108,129,182
Deductions:		
Losses and loss adjustment expenses incurred	\$65,979,108	
Other underwriting expenses incurred	38,124,706	
Assignment credit fee expense	<u>90,796</u>	
Total underwriting deductions		<u>104,194,610</u>
Net underwriting gain or (loss)		\$ 3,934,572

Investment Income

Net investment income earned	\$ 8,331,054	
Net realized capital gain	<u>(105,141)</u>	
Net investment gain or (loss)		8,225,913

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (225,569)	
Finance and service charges not included in premiums	933,929	
Miscellaneous income	<u>31,171</u>	
Total other income		<u>739,531</u>
Net income before dividends to policyholders and before federal income taxes		\$ 12,900,016
Dividends to policyholders		<u>51,134</u>
Net income after dividends to policyholders but before federal income taxes		\$ 12,848,882
Federal income taxes incurred		<u>3,965,627</u>
Net income		\$ <u>8,883,255</u>

C. Capital and Surplus

Surplus as regards policyholders increased \$8,358,331 during the five-year examination period January 1, 2014 through December 31, 2018, as reported by the Company, detailed as follows:

Surplus as regards policyholders, as reported by the Company as of December 31, 2013			\$24,462,836
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$8,883,255		
Net unrealized capital gains or (losses)		\$141,356	
Change in net deferred income tax		517,000	
Change in nonadmitted assets	<u>133,432</u>	<u>0</u>	
Total gains and losses	<u>\$9,016,687</u>	<u>\$658,356</u>	
Net increase (decrease) in surplus			<u>8,358,331</u>
Surplus as regards policyholders, as reported by the Company as of December 31, 2018			<u>\$32,821,167</u>

No adjustments were made to surplus as a result of this examination.

At December 31, 2018, capital paid in was \$4,200,000, consisting of 100,000 shares of common stock at \$42 par value per share. Gross paid in and contributed surplus was \$20,800,000, which did not change during the examination period.

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$27,249,579 is the same as that reported by the Company as of December 31, 2018. 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 SSAP No. 55. The reported reserves are concentrated in the commercial multiperil line, which is consistent with the business written by the Company.

5. **COMPLIANCE WITH PRIOR REPORT ON EXAMINATION**

The prior report on examination contained the following recommendation (page number refers to the prior report):

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Loss and Loss Adjustment Expenses</u>	
It was recommended that the Company ensure that the Actuarial Report underlying its Statement of Actuarial Opinion complies with the NAIC Annual Statement Instructions.	16

The Company has complied with this recommendation.

6. **SUMMARY OF COMMENTS AND RECOMMENDATIONS**

This report on examination contains no comments or recommendations.

Respectfully submitted,

\_\_\_\_\_/S/  
Wayne Longmore  
Associate Insurance Examiner

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

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

\_\_\_\_\_/S/  
Wayne Longmore

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:

**Wayne Longmore**

as a proper person to examine the affairs of the

**Merchants Preferred 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 8th day of January 2019

MARIA T. VULLO  
Superintendent of Financial Services



By:

*Joan P. Riddell*

Joan Riddell  
Deputy Bureau Chief