

REPORT ON EXAMINATION

OF THE

EXCISE BOND UNDERWRITERS

AS OF

NOVEMBER 30, 2004

DATE OF REPORT

SEPTEMBER 7, 2006

EXAMINER

GILBERT DENTON

## TABLE OF CONTENTS

<u>ITEM NO.</u>		<u>PAGE NO.</u>
1	Scope of examination	2
2.	Description of Underwriters	3
	A. Management	3
	B. Territory and plan of operation	4
	C. Amended excise reinsurance agreement – May 1, 1968	4
	D. Significant operating ratios	5
	E. Accounts and records	6
3.	Financial statements	7
	A. Balance sheet	7
	B. Underwriting and investment exhibit	8
4.	Investments	9
5.	Market conduct activities	9
6.	Compliance with prior report on examination	10
7.	Summary of comments and recommendations	11



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

September 7, 2006

Honorable Howard Mills  
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 22423 dated October 15, 2005 attached hereto, I have made an examination into the condition and affairs of Excise Bond Underwriters as of November 30, 2004, and submit the following report thereon.

Wherever the designations "the Company" or "the Underwriters" appear herein without qualification, they should be understood to indicate Excise Bond Underwriters.

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

The examination was conducted at the Company's administrative offices located at 15 Maiden Lane, New York, NY 10038.

## 1. SCOPE OF EXAMINATION

The previous examination was conducted as of November 30, 1999. This examination covered the five-year period from December 1, 1999 through November 30, 2004. 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 November 30, 2004. 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 ("CPA"). 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 ("NAIC"):

- History of Company
- Management and control
- Underwriters' accounts and records
- Fidelity bond and other insurance
- Territory and plan of operation
- Growth of Underwriters
- Business in force
- Loss experience
- Financial statements
- Employees' welfare and pension plans

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, which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

## 2. DESCRIPTION OF UNDERWRITERS

The Excise Bond Underwriters is an unincorporated association formed by stock casualty and surety insurers for the purposes of pooling operations. Business includes the reinsurance of losses arising from the issuance of insurance bonds required by the New York State Liquor Authority in connection with the manufacture, transportation or sale of alcoholic beverages.

### A. Management

The Underwriters operate under the provisions of an amended excise reinsurance agreement dated May 1, 1968, which provides for an executive committee. The functions of the committee are analogous to a corporate board of directors. Meetings are held twice a year. The members of the executive committee are selected by the members of the pool at a triennial meeting to serve for a term of three years.

Members of the executive committee as of November 30, 2004 were:

Fidelity & Deposit Company of Maryland  
 Great American Insurance Company  
 Hanover Insurance Company  
 Seaboard Surety Company  
 United States Fidelity & Guaranty Company

At November 30, 2004, the officers of the Underwriters were as follows:

<u>Name</u>	<u>Title</u>
John L. Comeau	President
Efthymia Tsoukalas	Vice president
Xhuhere Mehovic	Treasurer
Jonathan Weinrich	Counsel

In June 1978, the Company became a subscribing member of Affiliated Reinsurance Associations (“AreA”), a non-profit, non-incorporated organization established for the purpose of administration of all matters which involve its members. The functions performed by AreA consist of administrative and staff services and related activities necessary for efficient operations of all its members. Excluded from these functions are specific policy determinations and operations of each member as provided in the agreement subscribed to by each member. AreA functions include employment of all personnel, payment of general expenses, leasing of offices facilities and equipment, and custodianship of necessary files and records. As of November 30, 2004, other members of AreA were as follows:

Registered Mail Insurance Association  
Workers’ Compensation Reinsurance Bureau  
Railroad Insurance Underwriters

B. Territory and Plan of Operation

Business is acquired from agents and brokers throughout the State of New York, and is directly written by the Company at its home office. The Underwriters seek recovery from bond holding licensees for all claims paid to the State Liquor Authority (“SLA”) on the licensees’ behalf.

C. Amended Excise Reinsurance Agreement of May 1968

In accordance with the terms of this agreement, the member companies of Excise Bond Underwriters agreed to reinsure each other upon all excise bonds (bonds required by the State of New York in connection with the manufacture, transportation or sale of alcoholic beverages) executed by any member company. At November 30, 2004, the member companies and their percentage of participation in the Underwriters were as follows:

<u>Member</u>	<u>Percentage</u>
Fidelity & Deposit Company of Maryland	22.193%
Great American Insurance Company	16.649
Hanover Insurance Company	27.870
Seaboard Surety Company	11.095
United States Fidelity & Guaranty Company	<u>22.193</u>
Total	<u>100.00%</u>

Distributions of earnings were made to member companies during 2000, 2001, 2002, 2003 and 2004.

D. Significant Operating Ratios

The following ratios have been computed as of November 30, 2004, based upon the results of this examination:

Net premiums written in 2004 to surplus as regards policyholders	5.3:1*
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	96.0%
Premiums in course of collection to surplus as regards policyholders	61.8%*

The above ratios denoted with an asterisk fall outside the benchmark ranges established in the Insurance Regulatory Information System of the National Association of Insurance Commissioners. The ratios exceeded the benchmark ranges pursuant to the examination adjustments.

The underwriting ratios presented below are on an earned/incurred basis and encompass the three-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$ 708,314	20.06%
Other underwriting expenses incurred	2,957,627	83.75
Net underwriting loss	<u>(134,667)</u>	<u>(3.81)</u>
Premiums earned	<u>\$3,531,274</u>	<u>100.00%</u>

E. Accounts and Records

i. Financial Statements

During the examination process it was learned that the Company does not file year-end certified financial statements with the Superintendent. It is recommended that the Company file certified year-end financial statement reports with the Department on an annual basis.

ii. Investments

The Company reported an asset under the captioned “Investments – U.S. Treasury Notes and Bills” on its 2004 financial statement. A review of this item revealed that it was actually comprised of investments in annuities. Annuities are not equivalent to U.S Treasury notes and bills and should not be labeled as such. Annuities are not backed by the full faith and credit of the U.S Government, nor do they function in a similar way. It is recommended that the Company properly identify its investments on its financial statements.



### 3. FINANCIAL STATEMENTS

#### A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as determined by this examination as of November 30, 2004 and as reported by the Company:

	<u>Examination</u>	<u>Company</u>	<u>Surplus Increase (Decrease)</u>
<u>Assets</u>			
Investments	\$ 958,371	\$1,000,000	\$(41,629)
Cash and cash equivalents	149,412	149,412	
Investment income receivable	2,795	2,795	
Premiums in course of collection, net of commissions	71,880	71,880	
Special deposit – Post Office	300	300	
Advances to AreA	<u>55,000</u>	<u>55,000</u>	<u>0</u>
Total admitted assets	<u>\$1,237,758</u>	<u>\$1,279,387</u>	<u>\$(41,629)</u>
<u>Liabilities</u>			
	<u>Examination</u>	<u>Company</u>	<u>Surplus Increase (Decrease)</u>
Losses	\$ 32,401	\$ 32,401	\$ 0
Loss adjustment expenses	43,488	43,488	0
Taxes, licenses and fees (excluding federal and foreign income taxes)	3,362	3,362	0
Unearned premiums	941,335	941,335	0
Other expenses (payable to parent)	<u>45,917</u>	<u>45,917</u>	<u>0</u>
Total liabilities	<u>\$1,066,503</u>	<u>\$1,066,503</u>	<u>\$ 0</u>
Members' Equity	<u>\$171,255</u>	<u>\$ 212,884</u>	<u>\$(41,629)</u>
Total liabilities and members' equity	<u>\$1,237,758</u>	<u>\$1,279,387</u>	<u>\$(41,629)</u>

NOTE: Excise Bond Underwriters is a not-for-profit association. It is not required to file a federal income tax return.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders decreased \$191,941 during the five-year examination period December 1, 1999 through November 30, 2004, detailed as follows:

Statement of Income

Underwriting Income

Premiums earned		\$ 3,531,274
Deductions:		
Losses and loss adjustment expenses incurred	\$ 708,314	
Other underwriting expenses incurred	<u>2,957,627</u>	
Total underwriting deductions		<u>3,665,941</u>
Net operating loss		\$ (134,667)

Investment Income

Net realized capital gains	\$ 205,457	
Net investment gain		205,457

Other Income

Service charges	\$ 11,330	
Refunds to agents	<u>(608)</u>	
Total other income		<u>10,722</u>
Net income		\$ <u>81,512</u>

Members' Equity

Members' equity per report on examination as of November 30, 1999			\$308,196
	Gains in <u>Surplus</u>	Losses in <u>Surplus</u>	
Net income	\$81,512		
Change in non-admitted assets		\$ 39,234	
Distributions to member companies	<u>                    </u>	<u>179,219</u>	
Total gains and losses	<u>\$81,512</u>	<u>\$218,453</u>	
Net decrease in Members' equity			<u>136,941</u>
Members' equity per report on examination as of November 30, 2004			<u>\$171,255</u>

**4. INVESTMENTS**

The examination admitted value for the captioned account of \$958,371 is \$41,629 less than the \$1,000,000 reported by the Company in its November 30, 2004 financial statement. The Company reported value of \$1,000,000 represents the initial premium payment amount of the three annuities comprising this asset. Annuities are considered a type of life insurance policy and would therefore be subject to the provisions of Paragraph 6 of SSAP 21 (Cash Value of Life Insurance Where the Reporting Entity is Owner and Beneficiary), which states:

“The cash value of life insurance policies where the reporting entity is the owner and beneficiary is similar to a cash deposit that is realizable on demand. As such, the cash value of a life insurance policy as of the date to which premiums have been paid, less any outstanding policy loans and surrender charges, shall be reported as an admitted asset.”

The examination value represents the current withdrawal value (the annuity value less any withdrawal charges) of these investments as reported by the custodian. It is recommended that the Company report its investments in annuities at the current withdrawal value pursuant to the provisions of Paragraph 6 of SSAP 21.

**5. MARKET CONDUCT**

In the course of this examination, a review was made of the manner in which the Underwriters conducts its business practices and fulfills its contractual obligations to bondholders. The review was limited in nature and it not to be construed to encompass the generally more precise scope of a market

conduct examination which is the responsibility of the Market Conduct Unit of the Property Bureau of this Department.

Excise Bond Underwriters accept all applications for liquor, beer and permits bonds. There are no underwriting functions to be performed, since all the bond applications are accepted. Claims are paid to the State Liquor Authority when the bondholders are fined by the SLA. This procedure limits the claims processing functions performed by the Company that are common to most insurance companies. Most of the bonds are sold by brokers throughout New York State.

Examination procedures performed found no violations of the New York Insurance Law or Department Regulations.

## 6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Accounts and Records</u>	
1. As of November 30, 1999, the Company had, as its sole investment, an investment in a Government Security Mutual Fund. Investments that are not amortized are to be carried at market value. The Company reported this investment at cost in its financial statement even though the market value of this investment had decreased since the time of purchase. No change was made to the financial section of this report, due to immateriality.	11
<p>It is recommended that the Company report its investments according to Section 1414 of the New York Insurance Law.</p> <p>The Company has not complied with this recommendation. However, its investment portfolio has changed, so this recommendation does not need to be repeated herein.</p>	
2. It is recommended that the Company be mindful of the statutory prohibition of prepaid expenses as an admitted asset, pursuant to Section 1302(a) of the New York Insurance law, should such amounts become a material percentage of its balance sheet.	12
<p>The Company has not complied with this recommendation. This recommendation is repeated herein.</p>	

**7. SUMMARY OF COMMENTS AND RECOMMENDATIONS**

<u>ITEM</u>		<u>PAGE NO.</u>
A.	<u>Accounts and Records</u>	
1.	<u>Financial Statement</u>	
	It is recommended that the Company file a copy of its certified year-end financial statement reports with the Department on an annual basis.	6
2.	<u>Investments</u>	
A.	It is recommended that the investments in annuities not be classified as U.S Treasury notes and bills.	6
B.	It is recommended that investment in annuities be reported at the current withdrawal value.	9

Respectfully submitted,

\_\_\_\_\_/S/  
Gilbert Denton,  
Senior Insurance Examiner

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

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

\_\_\_\_\_/S/  
Gilbert Denton

Subscribed and sworn to before me

this \_\_\_\_\_ day of \_\_\_\_\_, 2006.

Appointment No 22423

STATE OF NEW YORK  
INSURANCE DEPARTMENT

I, HOWARD MILLS, Superintendent of Insurance of the State of New York,  
pursuant to the provisions of the Insurance Law, do hereby appoint:

**Gilbert Denton**

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

**EXCISE BOND UNDERWRITERS**

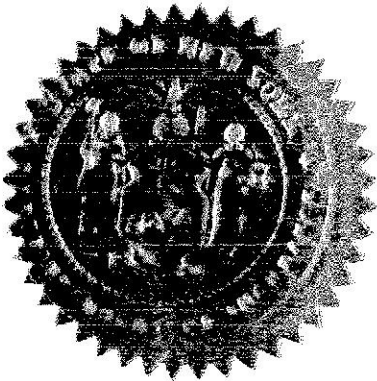
*and to make a report to me in writing of the condition of the said*

**UNDERWRITERS**

*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 13th day of October, 2005*



A handwritten signature in cursive script, appearing to read "Howard Mills".

\_\_\_\_\_  
HOWARD MILLS  
Superintendent of Insurance