

REPORT ON EXAMINATION

OF THE

LEATHERSTOCKING COOPERATIVE INSURANCE COMPANY

AS OF

DECEMBER 31, 2006

DATE OF REPORT

MAY 25, 2007

EXAMINER

NYANTAKYI AKUOKO

TABLE OF CONTENTS

<u>ITEM NO.</u>		<u>PAGE NO.</u>
1	Scope of Examination	2
2.	Description of Company	2
	A. Management	3
	B. Territory and plan of operation	4
	C. Reinsurance	5
	D. Holding company system	7
	E. Significant operating ratios	7
	F. Accounts and records	8
3.	Financial Statements	10
	A. Balance sheet	10
	B. Underwriting and investment exhibit	12
4.	Losses and loss adjustment expenses	13
5.	Market conduct activities	13
6.	Compliance with prior report on examination	16
7.	Summary of comments and recommendations	17



STATE OF NEW YORK
INSURANCE DEPARTMENT
ONE COMMERCE PLAZA
ALBANY, NEW YORK 12257

May 25, 2007

Mr. Eric R. Dinallo
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 22535 dated January 30, 2007 attached hereto, I have made an examination into the condition and affairs of Leatherstocking Cooperative Insurance Company as of December 31, 2006, and submit the following report thereon.

Wherever the designations “the Company” or “LCIC” appear herein without qualification, they 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 Insurance Department.

The examination was conducted at the Company’s home office located at 103 Main Street, Cooperstown, New York 13326.

1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 2001. This examination covered the five-year period from January 1, 2002 through December 31, 2006. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination comprised a verification of assets and liabilities as of December 31, 2006. 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
- Corporate records
- Fidelity bond and other insurance
- Territory and plan of operation
- Growth of Company
- 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 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 COMPANY

The Company was organized in 1886, as The Otsego Middlefield and Hartwick Town Fire Insurance Company as a town assessment co-operative fire insurance company to do business in the Towns of Otsego, Hartwick and Middlefield. In 1887 the Company re-organized under the name Otsego County Farmers' Co-operative Fire Insurance Company, for the purpose of transacting business as an assessment co-operative fire insurance company in Otsego County, New York.

On December 27, 1910, a certificate was issued by this Department authorizing the Company to continue to do business as an assessment co-operative fire insurance company in the counties of Otsego, Delaware and Chenango. Effective January 1, 1987, the Company was licensed to write business in all counties of the State of New York except the counties of New York, Kings, Queens, Bronx and Richmond.

Effective October 1, 1990, the Company was authorized by this Department to change its corporate title to the Leatherstocking Cooperative Insurance Company.

On July 15, 2002, this Department approved a change in the Company's charter to add boiler and machinery to the lines of business it was authorized to write.

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 nine nor more than twenty-five members. The board meets, at least, four times during each calendar year. At December 31, 2006, the board of directors was comprised of the following twelve members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Wayne Douglas Benjamin Morris, NY	Vice President, LCIC
John Edward Clow Cooperstown, NY	Retired
Peter Lewis Craig Hartwick, NY	President, LCIC
Nathan Robert Fenno Cooperstown, NY	Attorney Delaware & Otsego Railroad
Sue Ann Giudice Franklin, NY	Manager, Chen-Del-O Federal Credit Union
Eric Charles Hage Cooperstown, NY	Manager, Mohican Hedge Fund
Carl Johansen Edmeston, NY	Secretary, LCIC

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Philip Addison Lewis Cooperstown, NY	Vice President, LCIC
Richard Frederick Lohrman Franklin, NY	Retired
Kim Kucharski Muller Oneonta, NY	Retired
Carol Bill Ronovech Portlandville, NY	Certified Public Accountant Morris & Ronovech
Lynn John Woodard South New Berlin, NY	Retired

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

As of December 31, 2006, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Peter Lewis Craig	President
Wayne Douglas Benjamin	Vice President
Philip Addison Lewis	Vice President
Carl Johansen	Secretary
Mary Ann Willoughby	Treasurer
Maria Kay Abbott	Assistant Treasurer

B. Territory and Plan of Operation

As of December 31, 2006, the Company was licensed to write business in New York only.

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 ("NYIL"):

<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 following schedule shows the direct premiums written by the Company both in total and in New York for the period under examination:

<u>Calendar Year</u>	<u>Direct Premium Written (000)</u>
2002	\$3,036
2003	3,657
2004	4,490
2005	5,036
2006	5,515

Based on the lines of business for which the Company is licensed and pursuant to the requirements of Articles 13 and 66 of the NYIL, the Company is required to maintain a minimum surplus to policyholders in the amount of \$100,000.

The Company's major lines of business are homeowners multiple peril, commercial multiple peril and fire, which accounted for 43.3%, 43.0% and 7.7% respectively, of the 2006 direct written premiums. LCIC writes direct through independent agents.

C. Reinsurance

The Company did not assume any reinsurance as of December 31, 2006.

The company has structured its ceded reinsurance program to limit its maximum exposure to any one risk as follows:

<u>Type of treaty</u>	<u>Cession</u>
Excess of Loss:	
Property (3 layers)	\$540,000 in excess of \$60,000, ultimate net loss each loss, each risk, subject to a limit of liability of \$200,000, \$300,000 and \$600,000 each loss occurrence for each respective layer The first layer is subject to an annual aggregate deductible of 4% of the Company's subject premium
Casualty (3 layers)	\$970,000 excess of \$30,000 ultimate net loss each loss occurrence
Casualty clash	\$1,000,000 in excess of \$1,000,000 ultimate net loss each loss occurrence
Property Catastrophe Excess of Loss (3 Layers)	95% of \$950,000 excess of \$50,000 ultimate net loss, each loss occurrence involving three or more risks 100% ultimate net loss in excess of \$1,000,000 each loss occurrence
Aggregate Excess of Loss	95% of ultimate net loss in excess of 70% of the net earned premium subject to a limit of liability of 95% of \$750,000

In addition to its treaty reinsurance program, the Company obtained property facultative reinsurance program coverage. The maximum cession for the program is four times the Company's net retention, subject to a minimum retention of \$200,000 and a maximum cession of \$750,000 on any one risk. If the cession is greater than \$250,000, the maximum cession as respects any one animal shall not exceed \$250,000. The Company also obtained a casualty facultative excess of loss treaty covering casualty risks in excess of \$1,000,000.

Since the previous examination, the Company's retention has increased from \$40,000 to \$60,000 on property business and \$18,000 to \$30,000 on casualty business. All business was ceded to authorized/accredited reinsurers.

All 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 NYIL.

Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect 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. 62. Representations were supported by attestations from the Company's President/Vice 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 paragraph 25 of SSAP No. 62.

D. Holding Company System

As of December 31, 2006, the Company was independent with no affiliation or pooling agreements in force.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2006, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	0.98 to 1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	52%
Premiums in course of collection to surplus as regards policyholders	3%

All of 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 five-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$7,734,047	50.97%
Other underwriting expenses incurred	5,709,870	37.63
Net underwriting gain	<u>1,729,454</u>	<u>11.40</u>
Premiums earned	<u>\$15,173,371</u>	<u>100.00%</u>

F. Accounts and Records

i. Custodial agreement

On examination it was determined that the custodial agreement between the Company and the custodian of its securities did not contain certain provisions and safeguards as set forth in the NAIC Financial Condition Examiners Handbook.

During the course of the examination, the Company amended the custodial agreement to include the missing provisions and safeguards; nevertheless, it is recommended that going forward, the Company ensures that its custodial agreement contains satisfactory safeguards and controls including the provisions as set forth in the NAIC Financial Condition Examiners Handbook.

ii. Loss retention

The Company's reinsurance programs for each of the years covered by the examination contained a provision which required the Company to maintain, in respect of Property Losses, an annual aggregate deductible equal to 4% of its subject premium. The 2005 and 2006 contracts specifically stated that, "The Reinsurer shall not be liable for any Ultimate Net Loss hereunder until such annual deductible is satisfied. However, this provision shall not apply to the extent that it would result in the Company violating New York Insurance Code §6610." An examination review of loss

files to test the proper application of reinsurance contract provisions indicated that the Company has been applying the annual aggregate deductible to certain claims without regard to the limitation placed on a single property risk by Section 6610(c) of the NYIL. The application of the deductible in addition to the minimum retention per risk, resulted in the Company's net retention for certain claims, in excess of the limitation set forth in Section 6610(c).

Therefore, it is recommended that the Company, when applying the annual aggregate deductible, be mindful of the limitations set forth in Section 6610(c) of the NYIL and limit its net insurance on a single property risk accordingly.

3. FINANCIAL STATEMENTSA Balance Sheet

The following shows the assets, liabilities, and surplus as regards policyholders as of December 31, 2006 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Examination</u>		Net Admitted <u>Assets</u>
	<u>Assets</u>	Assets Not <u>Admitted</u>	
Bonds	\$6,031,257	\$ 0	\$6,031,257
Common stocks	1,236,990	0	1,236,990
Cash, cash equivalents and short-term investments	1,324,460	0	1,324,460
Other invested assets	5,000	5,000	0
Investment income due and accrued	78,621	0	78,621
Uncollected premiums and agents' balances in the course of collection	134,958	0	134,958
Deferred premiums, agents' balances and installments booked but deferred and not yet due	579,598	0	579,598
Amounts recoverable from reinsurers	214,696	0	214,696
Net deferred tax asset	86,500	0	86,500
Furniture and equipment, including health care delivery assets	<u>25,360</u>	<u>25,360</u>	<u>0</u>
Totals	<u>\$9,717,440</u>	<u>\$30,360</u>	<u>\$9,687,080</u>

Liabilities, surplus and other funds

Losses and loss adjustment expenses		\$1,444,186
Commissions payable, contingent commissions and other similar charges		166,837
Other expenses (excluding taxes, licenses and fees)		137,802
Current federal and foreign income taxes		314,041
Unearned premiums		2,920,716
Advance premium		73,872
Ceded reinsurance premiums payable (net of ceding commissions)		49,022
Amounts withheld or retained by company for account of others		8,897
Remittances and items not allocated		<u>6,451</u>
Total liabilities		\$5,121,824
Required surplus	\$ 100,000	
Unassigned funds (surplus)	<u>4,465,256</u>	
Surplus as regards policyholders		<u>4,565,256</u>
Totals		<u>\$9,687,080</u>

Note: The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2002 through 2006. 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. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$2,803,907 during the five-year examination period January 1, 2002 through December 31, 2006, detailed as follows:

Underwriting Income

Premiums earned		\$15,173,371
Deductions:		
Losses and loss adjustment expenses incurred	\$7,734,047	
Other underwriting expenses incurred	<u>5,709,870</u>	
Total underwriting deductions		<u>13,443,917</u>
Net underwriting gain or (loss)		\$1,729,454

Investment Income

Net investment income earned	\$1,119,605	
Net realized capital gain	<u>58,855</u>	
Net investment gain or (loss)		1,178,460

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$(33,304)	
Finance and service charges not included in premiums	451,337	
Aggregate write-ins for miscellaneous income	<u>2,822</u>	
Total other income		<u>420,855</u>
Net income before dividends to policyholders and before federal and foreign income taxes		<u>\$3,328,769</u>
Dividends to policyholders		<u>0</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$3,328,769
Federal and foreign income taxes incurred		<u>1,225,073</u>
Net Income		<u>\$2,103,696</u>

Surplus as regards policyholders per report on examination as of December 31, 2001 \$1,761,349

	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$2,103,696	\$ 0	
Net unrealized capital gains	135,189	0	
Change in net deferred income tax	38,019	0	
Change in nonadmitted assets	446,873	0	
Cumulative effect of changes in accounting principles	<u>80,130</u>	<u>0</u>	
Net increase (decrease) in surplus	\$2,803,907	\$ 0	<u>\$2,803,907</u>
Surplus as regards policyholders per report on examination as of December 31, 2006			<u>\$4,565,256</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability of \$1,444,186 is the same as the amount 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.

5. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the 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 areas:

- A. Sales and advertising
- B. Underwriting
- C. Rating
- D. Claims and complaint handling

Except as noted below, no unfair practices were encountered.

Maintenance of claim files

During the review of claim files, it was discovered that the Company had made adjustments to case reserves for certain claims in the electronic database, when such adjustments had not been recorded on the Claim File Reserve Sheets maintained within the hardcopy claim files. Since the Company does not maintain computerized claim files, the hardcopy files are the primary source from which data should flow to the electronic database.

Part 216.11 of the Department Regulation 64 requires that claim files should be maintained such that all events relating to a claim can be reconstructed by the Insurance Department examiners. It is recommended that the Company maintain claim files in a manner that will facilitate compliance with the requirements of Part 216.11 of the Department Regulation 64.

It is also recommended that the Company implement proper internal controls that will ensure that both the claim file and the electronic database reflect all data adjustments.

The New York Mortgagee Clause

On the prior examination it was noted that the Company was not giving ten days advanced notices to mortgagees when an insurance policy was being cancelled at the insured's request. The New York Standard Mortgagee Clause, as reaffirmed by Department Circular Letter 17 of 1976, requires that such notice be given to mortgagees before their interest in such policies is cancelled. On the current examination, cancellation notices mailed to insureds and mortgagees, for policies cancelled at the request of the insured were reviewed and it was noted that the proof of mailing indicated that the Company still was not providing the 10-days advanced notices to mortgagees when an insurance policy was being cancelled at the insured's request. In a response to the current examination finding, the Company indicated that it had implemented a system in which mortgagees were provided with thirty-three days advance notice when policies are cancelled at the request of insured. However, the Company did not maintain copies of the notices and as such the examination was unable to verify that such notice had been provided to the mortgagees for the policies sampled.

Therefore, it is recommended that the Company maintain records to support compliance with Department Circular Letter No. 17 of 1976 when canceling policies with mortgagees' interests.

Rate Approval

During the re-rating of some selected policies, it was noted that the Company rounded up the rate factors when multiplying such factors by the Special Multi-Peril (“SMP”) factor to arrive at the premium rates. The rating method utilized was a deviation from the provisions of the SMP Rating Manual. Such deviation was not specifically approved by the board of directors.

Section 6615(a)(1) of the NYIL states in part that, “Every assessment corporation may, if so directed by its directors, levy an assessment upon its members.” Therefore, it is recommended that the Company fully comply with Section 6615(a)(1) of the NYIL and rate policies in accordance with the specific rating rules approved by the board of directors.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
It was recommended that three directors either improve their attendance records at board meetings or be replaced by policyholders.	4
The Company has complied with this recommendation.	
B. <u>Limitation of Investments</u>	
It was recommended that the Company comply with Section 1409(a) of the Insurance Law and not invest more than ten percent of its admitted assets in any one institution.	13
The Company has complied with this recommendation.	
C. <u>Market Conduct Activities</u>	
It was recommended that the Company comply with the provisions of the New York Standard Mortgagee Clause, henceforth, when canceling such policies containing same.	14
The Company did not maintain the records in order for this examination to verify compliance with this recommendation. A recommendation regarding this finding is made in this report.	

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>		<u>PAGE NO.</u>
A.	<u>Accounts and Records</u>	
i.	It is recommended that going forward the Company ensures that its custodial agreement contains satisfactory safeguards and controls including the provisions as set forth in the NAIC Financial Condition Examiners Handbook	8
ii.	It is recommended that the Company, when applying the annual aggregate deductible, be mindful of the limitations set forth in Section 6610(c) of the NYIL and limit its net insurance on a single property risk accordingly.	8 – 9
B.	<u>Market Conduct Activities</u>	
i.	It is recommended that the Company maintain claim files in a manner that will facilitate compliance with the requirements of Part 216.11 of the Department Regulation 64. It is also recommended that the Company implement proper internal controls that will ensure that both the claim files and the electronic database reflect all data adjustments.	14
ii.	It is recommended that the Company maintain records to support compliance with Department Circular Letter 17 of 1976 when cancelling policies with mortgagees' interests.	14
iii.	It is recommended that the Company fully comply with Section 6615(a)(1) of the NYIL and rate policies in accordance with the specific rating rules approved by its board of directors.	15

Respectfully submitted,

Nyantakyi Akuoko
Senior Insurance Examiner

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

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

Nyantakyi Akuoko

Subscribed and sworn to before me

this _____ day of _____, 2007.

Appointment No 22535

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, **Eric R. Dinallo**, Acting Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:

Nyantakyi Akuoko

as proper person to examine into the affairs of the

Leatherstocking Cooperative Insurance Company

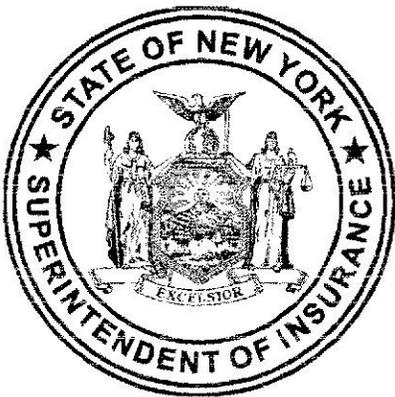
and to make a report to me in writing of the condition of the said

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 30th day of January 2007



A handwritten signature in black ink, appearing to read "Eric Dinallo", written over a horizontal line.

Eric R. Dinallo
Acting Superintendent of Insurance