<u>REPORT ON EXAMINATION</u>

<u>OF THE</u>

<u>COLONIAL COOPERATIVE INSURANCE COMPANY</u>

<u>AS OF</u>

<u>DECEMBER 31, 2002</u>

| | |
|---|---|
| <u>DATE OF REPORT</u> | <u>APRIL 29, 2004</u> |
| <u>EXAMINER</u> | <u>FE ROSALES, CFE</u> |

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

April 29, 2004

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 22093 dated September 29, 2003 attached hereto, I have made an examination into the condition and affairs of Colonial Cooperative Insurance Company as of December 31, 2002, and submit the following report thereon.

The examination was conducted at the Company‘s administrative offices located at 380 Washington Avenue, Kingston, NY 12401.

Wherever the designations “the Company” or “CCIC” appear herein without qualification, they should be understood to indicate Colonial Cooperative Insurance Company.

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

## 1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1997. This examination covered the five-year period from January 1, 1998 through December 31, 2002. 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, 2002. 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 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 bond and other insurance
Territory and plan of operation
Growth of Company
Business in force by states
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 1896 as the Olive Co-operative Fire Insurance Association ("Association") for the purpose of transacting business as a cooperative fire insurance corporation in the Towns of Olive, Marbletown and Shandaken in Ulster County, New York. Subsequently, the Company's territory was extended to include all the counties of New York State.

In 1957, the Association was authorized to issue non-assessable policies. In 1964, the Department approved a change of name for the Association to the Colonial Cooperative Insurance Company.

### 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 fifteen members. As of the examination date, the board of directors was comprised of ten members, divided into three groups, with one group being elected at each annual policyholders' meeting for a term of three years. At least four board meetings were held each year for the period under examination, thereby complying with Section 6624(b) of the New York Insurance Law (NYIL).

The directors as of December 31, 2002 were as follows:

| Name and Residence | Principal Business Affiliation |
|---|---|
| H. Clark Bell<br>Woodstock, New York | Semi-retired Attorney |
| William Helmrich<br>Kingston, New York | Retired |

| Name and Residence | Principal Business Affiliation |
|---|---|
| Clarence K. Howe<br>Rhinebeck, New York | Retired |
| Patricia Jordan<br>Kingston, New York | Certified Public Accountant;<br>Chief Financial Officer of Jordan International |
| John Masselli, Jr.<br>South Cairo, New York | Vice President of CCIC |
| Lewis Neporent<br>Kingston, New York | Retired |
| Kenneth Pangburn<br>Kingston, New York | President of CCIC |
| Bernard Redmond<br>Kingston, New York | Retired |
| Stephen Selig<br>New York, New York | Semi-retired Attorney;<br>Senior Counsel,<br>Brown, Rasmond, Millstein, Fielder and<br>Steiner, LLP |
| William West<br>Woodstock, New York | Secretary & Treasurer of CCIC<br>Contractor;<br>Retired former Chairperson of Ulster County<br>Legislature |

The minutes of all meetings of the board of directors and committees thereof held during the examination period were reviewed. Except for two former directors' (Laurie Linton and Mark Sarlitto) attendance records, the meetings were generally well attended.

It was noted that the two above-named directors attended less than 50% of the meetings they were eligible to attend. Ms. Linton attended only one meeting out of the eight meetings she was eligible to attend (or 13% attendance record). Mr. Sarlitto attended two out of the five meetings he was eligible to attend (40% attendance record).

Members of the board have a fiduciary responsibility and must evince on an on going interest in the affairs of the Company. It is essential that board members attend meetings consistently and set forth their views on relevant matters so that appropriate policy decisions may be reached by the board. Individuals who fail to attend at least one-half of the board's meetings do not fulfill such criteria.

It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.

It is noted that the above-indicated directors were no longer directors as of February 2001.

Moreover, during the review of the Company's by-laws and its corporate minute books, the following items were noted:

i. During the 1998 board meetings, it appears that the investment activity for 1997 was not approved, which is a violation of Section 1411(a) of the New York Insurance Law (NYIL). This section states in part that "No domestic insurer shall make any loan or investment, unless authorized or approved by its board of directors or a committee thereof responsible for supervising or making such investment or loan. The committee's minutes shall be recorded and a report submitted to the board of directors at its next meeting."

It is recommended that the Company fully comply with section 1411(a) of the NYIL and that the board exercise due care in approving the investment transactions.

ii. Article IV of the Company's by-laws requires that the Board shall consist of not more than fifteen and not less than nine directors. (Emphasis added) It is noted that on five meetings (May 2, June 19, August 24 and November 14, 2000; and March 22, 2001), the Board consisted of fewer than nine directors.

Section 6603(a)(5)(E) of the New York Insurance Law states that a cooperative property/casualty insurance companies' charter shall indicate the number of its directors, which shall not to be less than nine, and a provision that in no case shall the number of directors be less than nine.

It is recommended that the Company adhere to the provisions of Section 6603(a)(5)(E) of the New York Insurance Law and ensure the number of directors is not less than nine at all times.

*iii.* Article IV of the Company's by-laws requires that the Board shall consist of not more than fifteen and not less than nine directors, each of whom shall be a policyholder of the Company. (Emphasis added). It appears that a former director, Laurie Linton, was not a policyholder during her tenure as director from August 1999 through February 2001.

It is again recommended that the Company adhere to all the provisions of its by-laws. A similar recommendation was included in the prior report on examination.

The principal officers of the Company as of December 31, 2002 were as follows:

| Name | Title |
|---|---|
| Kenneth Pangburn | President and Chief Executive Officer |
| John Masselli, Jr. | Vice President |
| William West | Secretary & Treasurer |
| John Albin, Jr. | Chief Financial Officer |

## B. Territory and Plan of Operation

The Company is licensed to transact business in New York. The Company writes in New York State only.

The following schedule shows the direct premiums written by the Company during the examination period:

| Calendar Year | NYS Direct Written Premiums |
|---|---|
| 1998 | $6,049,974 |
| 1999 | 8,359,952 |
| 2000 | 8,642,669 |
| 2001 | 8,022,760 |
| 2002 | 8,669,655 |
| Total | $39,745,010 |

As of December 31, 2002, the Company was licensed to transact the kinds of insurance set forth in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

| Paragraph | Kind of Business |
|---|---|
| 4 | Fire |
| 5 | Miscellaneous property |
| 6 | Water Damage |
| 7 | Burglary and theft |
| 8 | Glass |
| 12 | Collision |
| 13 | Personal injury liability |
| 14 | Property damage liability |
| 19 | Motor vehicle and aircraft physical damage |
| 20 | Marine and inland marine (inland marine only) |

The Company was also licensed as of December 31, 2002, to accept and cede reinsurance as provided 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 $390,803.

At December 31, 2002, the Company wrote insurance through independent agents.

The Company's predominant line of business is commercial multiple peril, which accounted for 98.3% of the Company's 2002 direct written business.

Surplus to policyholders as of December 31, 2002, as reported in the Company's filed annual statement, was $581,698.

Gross premiums written in 2002 totaled $8.7 million consisting of all direct business, and of which $8.2 million were ceded to an affiliated entity.

C. Reinsurance

The Company does not assume any business.

1. Colonial Indemnity Insurance Company

Prior to 1998, the Company was a party to a “Pooling and Reinsurance Agreement” with Colonial Indemnity Insurance Company (“CIIC or Colonial Indemnity”). This agreement was effective April 1, 1988. Under such agreement CCIC ceded and CIIC assumed 100% of Colonial Cooperative’s direct business. Such business was pooled with the direct business of Colonial Indemnity. CCIC then assumed its respective participation of the pooled business to be limited to losses not in excess of $75,000 ($100,000 effective July 1, 1994). CIIC obtained excess and catastrophe coverage of 100% of losses in excess of $75,000 ($100,000 effective July 1, 1994).

The pool participation of the companies was as follows:

**April 1, 1988 – December 31, 1991:**

| | |
|---|---|
| Colonial Indemnity | 97.5% |
| Colonial Cooperative | 2.5% |

**January 1, 1992 – December 31, 1997:**

Property Business

| | |
|---|---|
| Colonial Indemnity | 95% |
| Colonial Cooperative | 5% |

Liability Business

| | |
|---|---|
| Colonial Indemnity | 100% |
| Colonial Cooperative | 0% |

CIIC paid all operating expenses incurred in the course of performance of this agreement. Colonial Cooperative reimbursed Colonial Indemnity, on a monthly basis, for its 5% share of all property operating expenses and agents' commission expenses incurred by the pool.

Effective December 31, 1997, this "Pooling and Reinsurance Agreement" was terminated by Colonial Indemnity.

In October 1997, Colonial Indemnity filed a complaint alleging purported cause of action against the Company for: (1) interference with prospective advantage, (2) for a permanent injunction against purported unfair competition and malicious conduct, and (3) for an accounting with respect to clients, potential clients and corporate opportunities that allegedly were diverted. With reference to the first purported cause of action above, the complaint sought general and special damages in the amount of $5 million. In April 1998, the court granted the Company's motion to compel arbitration of all causes of action alleged in Colonial Indemnity's complaint. Hence, an arbitration proceeding was commenced, involving Colonial Indemnity and the Company, to determine the rights of the parties pursuant to the Pooling and Reinsurance Agreement that was terminated. Management had vigorously contested the case.

In April 2002, this litigation with CIIC was settled. The Company paid $37,500 to CIIC to settle the case. The Company has indicated that due to increasing legal costs, it was in the best interest of the Company's policyholders to settle this case.

2. <u>New Hampshire Insurance Company (AIG Group)</u>

The Company entered into a "Pooling and Reinsurance Agreement" with New Hampshire Insurance Company ("NHIC") effective December 10, 1997, covering all new and renewal policies attaching on or after January 1, 1998. The Agreement provides for the quota-share assumption by NHIC of 99% of the business written by CCIC with the Company retaining 1% net quota share for both property and liability risks.

The agreement provides for NHIC, as reinsurer, to participate in the net fortunes of CCIC's underwriting, reinsurance, retrocessions, claim operations and operating expenses to the extent of NHIC's participation interests in the pool.

The Department, per letter dated December 10, 1997, found this agreement unobjectionable.

This agreement was endorsed effective January 1, 1999 to reflect the change in the limits of liability as follows:

On both Property and Casualty business, NHIC's limit of liability was 99% of $2,000,000 or $1,980,000. CCIC retained 1% of $2,000,000 or $20,000.

The above endorsement was non-objected to by the Department per letter dated March 16, 1999, but was limited to the current twelve-month period, January 1 to December 31, 1999. In addition, the Department advised the Company that on or before October 1, 1999, CCIC must submit to the Department a plan to increase its retention to at least ten percent for the next twelve-month period, January 1, to December 31, 2000.

3. NHIC and First Financial Insurance Company [“FFIC” of International Financial Group (IFG)]

Effective April 1, 1999, the “Pooling and Reinsurance Agreement” with NHIC was amended to reduce NHIC’s participation to 82% and added First Financial Insurance Company (“FFIC”) with a 17% participation, and CCIC retaining 1% of the business written. The participants’ limits of liability were as follows:

On both Property and Casualty business, NHIC’s limit was 82% of $2,000,000 or $1,640,000; FFIC’s limit was 17% of $2,000,000 or $340,000; and CCIC retained 1% of $2,000,000 or $20,000.

The above amendment was non-objected to by the Department per letter dated May 21, 1999.

Effective June 30, 1999, NHIC by mutual agreement terminated its pool participation. FFIC in turn picked up NHIC’s participation percentage, which increased FFIC’s participation total to 99%.

The above endorsement to the agreement was non-objected to by the Department per letter dated August 5, 1999.

Effective January 1, 2000 based upon the Department’s request, the participation percentage was changed to 95% of $2,000,000 for FFIC (or $1,900,000) and CCIC, 5% of $2,000,000 (or $100,000). Due to this change in participation percentage, it is noted that CCIC exceeded its risk limitation, which is 10% of the Company's surplus ($650,714 at 12/31/99 annual statement or $65,071); thus resulting in CCIC not being in compliance with the limitation of risks requirement. It is noted, however, that effective January 1, 2001, the agreement was further amended to change all references of $2,000,000 in the contract to be $1,000,000 bringing down CCIC’s limits to $50,000.

It is noted that the Department per letter dated January 8, 2001 provided its non-objection letter to the above amendment.

Pursuant to article 3 of the Pooling and Reinsurance Agreement, the Company was notified by FFIC per letter dated April 30, 2003 that effective December 31, 2003, the pooling agreement with FFIC is being terminated. Accordingly, the Company exercised the run-off provision of the agreement. (Refer also to Section I – Subsequent Events as regard to an arbitration proceeding relative to this agreement.)

It is noted during the review of the Company’s reinsurance contracts that an unnumbered Amendment to the Quota Share Reinsurance and Pooling Agreement between CCIC and FFIC effective January 1, 2001 and January 1, 2002 was executed by the parties in September 2003.

The amendment consisted of several pages and includes mostly exclusions amending the exclusions in the original agreement. These exclusions were effective January 1, 2002. Per correspondence included in the reinsurance file, this dates back to post September 11, 2001 when FFIC and CCIC agreed that whatever terrorism exclusions are imposed upon FFIC by their reinsurers, CCIC would accept. In addition, per the Company's advice, this was finalized in 2003 as a "clean-up" item prior to the contract termination effective December 31, 2003.

It is noted that this amendment was not forwarded to the Department for approval as there is no correspondence relating to this matter.

Section 1308(e)(3)(B) of the New York Insurance Law (NYIL) states in part:

> "If any agreement or agreements at any time effect reinsurance of substantially all of the net insurance in force of such ceding insurer, no credit by way of deduction pursuant to subsection (b) hereof shall be allowed to such ceding insurer, unless…
>
> (B) such reinsurance agreement or agreements were made under pooling arrangements between insurers associated in a group for underwriting purposes and were <u>approved by the superintendent</u> as not impairing the protection of policyholders of such ceding or assuming insurers". (Emphasis added.)

Furthermore, Section 1505(d)(2) of the NYIL states in part:

> "The following transactions between a domestic controlled insurer and any person in its holding company system may not be entered into <u>unless the insurer has notified the superintendent in writing of its intention to enter into any such transaction at least thirty days prior thereto, or such shorter period as he may permit and he has not disapproved it within such period:</u>
>
> <u>(2) reinsurance treaties or agreements".</u> (Emphasis added).

Based on the foregoing, the Company violated Sections 1308(e) and 1505(d)(2) of the NYIL.

It is recommended that the Company comply with Sections 1308(e) and 1505(d)(2) of the NYIL, henceforth and that the Company submit to the Department for approval all reinsurance agreements and amendments thereto .

4. <u>American Reinsurance Company</u>

The Company also entered into a 50% quota share reinsurance agreement effective August 1, 1998 with American Reinsurance Company (American Re) involving restaurant business covering, but not limited to Property General Liability and Liquor Legal Liability. American Re's limit was 50% of $250,000 or $125,000. This agreement was terminated effective December 31, 1999.

It is noted that the Company notified the Department of this agreement; however, there was no non-objection letter found in either the Department's or the Company's file relative to this agreement. Hence, the Company is yet again in violation of Section 1308(e) of the NYIL. (Refer to the recommendation.)

In addition, in June 1999, the Company entered into a facultative arrangement with American Reinsurance Company covering sixteen insureds. CCIC ceded property business in excess of $1 million. American Re had various limits on this assumption. Further in March and April 2000, CCIC again entered into two separate facultative arrangements with American Re, each covering one insured. The reinsurer's limits on each assumption were $200,000 in excess of $1 million and $45,000 in excess of $1 million, respectively. It is noted that CCIC ceded property business. The Company did not renew any of these facultative certificates after their expiration.

5. SCOR Reinsurance Company (SCOR Re)

Effective January 1, 2004, the Company entered into an excess of loss and quota share reinsurance agreements with SCOR Re as follows:

| Type of Contract | Cession |
| --- | --- |
| Property (1 layer)<br>100% Authorized | $900,000 ultimate net loss, each and every risk, each and every loss occurrence in excess of $100,000 ultimate net loss; subject to a maximum of $1,800,000, each and every loss occurrence. |

| | |
|---|---|
| Casualty (1 layer)<br>100% Authorized | $900,000 ultimate net loss, each and every loss occurrence in excess of $100,000 ultimate net loss; each and every loss occurrence. |

The Company also entered into a 50% quota share contract of the first $100,000 each loss, each and every policy. As respects property, there will be an occurrence limitation of $200,000 and the maximum policy limit subject to the agreement will not exceed $1 million per occurrence and $2 million aggregate.

It is noted that the Company has yet to receive a copy of the reinsurance agreement from the reinsurer.

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

The examiner reviewed all reinsurance contracts in effect during the examination period. Except as noted below, the contracts contained the required standard clauses including insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

A review of the Company's ceded reinsurance contracts during the examination period indicated the following:

i. Arbitration clause

A review of the Company's ceded reinsurance contract with American Reinsurance Company revealed that this contract does not contain an arbitration clause.

This Department requires that in the event of a dispute between an insurer and its reinsurer, arbitration must take place in the domiciliary state of the ceding company.

It is recommended that any future reinsurance contracts the Company enters into include an arbitration clause and indicate that any arbitration should take place within New York State.

ii. Offset Clause

The quota share reinsurance agreement with American Reinsurance Company contains a provision allowing for broad offset rights, as follows: "Each party hereto has the right, which may be exercised at any time, to offset any amounts … under this agreement or any other reinsurance agreement heretofore or hereafter entered into between them…" (Emphasis added). In reinsurance agreements containing such broad rights to offset, this Department requires that the following language be included:

> "In the event of the insolvency of either party to this agreement then offsets shall only be allowed to the extent permitted by the provision of Section 7427 of the New York Insurance Law."

It is recommended that any future reinsurance contracts the Company enters into include the required language in the offset provision in compliance with Section 7427 of the New York Insurance Law.

It is noted that the reinsurance agreement with American Reinsurance Company was terminated effective December 31, 1999.

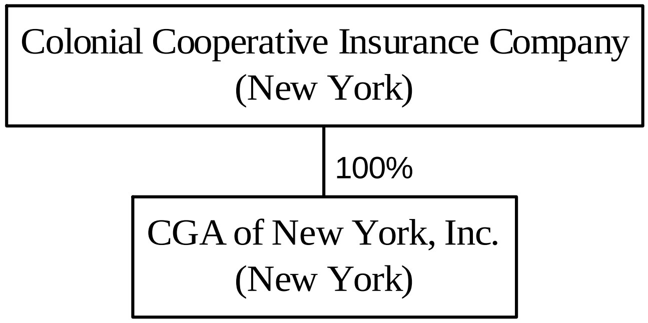
D. Holding Company System

During the examination period, the Company was considered to be a member of a holding company system due to the nature of its reinsurance and pooling agreement with New Hampshire Insurance Company (NHIC of the AIG Group) effective January 1, 1998. Under the agreement, NHIC assumed 99% quota-share of business written by CCIC and had 99% share in the Company's operating expenses. The Company retained 1% net quota share. As noted in the foregoing Reinsurance section, in June 1999, NHIC by mutual agreement terminated its pool participation. First Financial Insurance Company (FFIC) in turn picked up NHIC's participation and had been CCIC's pooling partner through December 31, 2003.

In a letter to the Department dated April 13, 2004, the Company requested removal from the category of a controlled insurer since control was taken back from FFIC representatives by the Company's board in March 2001.

During the examination period, the Company formed a wholly owned subsidiary, CGA of New York, Inc. (CGA). Per letter dated March 27, 2000, the Company was advised that the Department would not take exception to the organization of CGA with an initial investment by CCIC of $800 for 200 shares. This March 2000 letter further stated that should CCIC decide to make further investment in CGA beyond the $800 initial investment, the Company will advise the Department at least thirty days prior thereto, providing the specific purposes for which the investment is to be used and will submit a projection of the impact of such investment upon the operations of CCIC and CGA. It is noted, however, that CCIC made an initial investment of $2,500, as opposed to $800, in exchange for issuance to CCIC of 200 shares of common stock. It is noted that CCIC did not provide the Department prior notification of this increased investment to CGA.

An organizational chart reflecting the relationship between the Company and its subsidiary as of December 31, 2002 is as follows:




As of the examination date, the Company is a party to an Expense Sharing Agreement with CGA. The agreement is effective September 1, 1998 and per the Department’s letter dated October 16, 1998, CCIC was advised that the Department found said expense-sharing agreement unobjectionable. The agreement outlines the basis for expense allocation between the parties, but does not specifically indicate that such allocation will be in accordance with Department Regulation 30. The agreement shall remain in force until terminated by either party upon not less than 90 days written notice of such termination to the other party effective at the end of any month end during the agreement.

Per its annual meeting on February 13, 2003, CCIC's board of directors retroactively approved yet another Expense Sharing Agreement effective January 1, 2002. This new agreement calls for CGA to pay a management fee to CCIC for the purpose of sharing expenses associated with producing and servicing of CGA business. This agreement indicates further that CGA shall pay the larger of the following:

1. Minimum of $25,000 annual if net income supports being able to pay that amount.
2. 50% on net income of CGA after direct expenses. If the net income is less than the $25,000 minimum, CGA will then pay 50% of net income after direct expenses.

As indicated above, this new agreement was effective January 1, 2002, and will be continuous; however, either party can cancel the agreement with a 90-day notice at the end of the calendar year. Settlement of accounts is to be done on a semi-annual basis and the fee paid within 45-days from the end of June 30th and December 31st.

It is noted that this agreement was never submitted to the Department for review. The Company has indicated that the second agreement was entered into due to its belief that no expense sharing agreement was approved by CCIC's board and by the Department. It appears that since the first expense sharing agreement was filed with and approved by the Department in conjunction with the filing and approval of the CGA formation, the Company's President, who was not with the Company during the CGA formation in 1998, was not fully aware of the first agreement's existence. Accordingly, per the Company's correspondence dated April 14, 2004, the Expense Sharing Agreement effective January 1, 2002 will be withdrawn and that the agreement effective September 1, 1998 will be ratified and used going forward.

It is also noted that the Company's board of directors approved the consolidation of tax returns for CCIC and CGA starting tax year 2002. It is noted, however, that there is no tax allocation agreement in place between the parties.

Circular Letter No. 33 (1979) states in part that "Every domestic insurer which is a party to a consolidated federal income tax filing <u>must have a definitive written agreement,</u> approved by its Board of Directors, governing its participation therein." (Emphasis added.)

In view of the above, it is recommended the Company comply with Circular Letter No. 33 (1979) and that a written tax allocation agreement approved by the Company's board of directors be in place in order to assure fair and equitable inter-company transactions.

Pursuant to Regulation 53, Section 81-1.2, each year the Company must submit to the Department the required Regulation 53 filings. It is noted, however, that the Company did not submit the required filing for the years subsequent to 1999.

In addition, Sections 81-1.1(e) and 81-1.2(d) of Regulation 53 requires that financial statements for an insurer's subsidiary submitted to the Department be certified by an independent public accountant to the effect that such financials present fairly the subsidiary's financial position and the results of its operations for the year then ended, in conformity with generally accepted accounting principles (GAAP).

It is noted that CGA's balance sheet is included as part of the Notes to the Financial Statements in the CPA's CCIC audit report. CCIC's independent auditor has indicated that no separate audit opinion or audit report was issued since the audit of CGA is part of their audit of CCIC's Other Invested Asset account. However, it appears that there was no further audit work done for CGA.

In view of the above, it is recommended that the Company comply with the above sections of Regulation 53 by submitting the necessary Regulation 53 filings to the Department which should include a certified financial statement of CGA.

E. Abandoned Property Law

Section 1316 of the New York Abandoned Property Law requires the Company to file a report with the Office of the State Comptroller for any amount payable to the residents of New York State that are unclaimed for over three years. Except as noted below, the Company made the required filings with the Office of the State Comptroller for the two most recent years during the examination period.

It is noted that the Company was not able to provide a copy of their abandoned property filings for the years 1998, 1999 and 2000. The Company has indicated that CCIC personnel did not have access to the records pertaining to the above-noted years. However, despite the fact the Company asserted that access to those records was not possible, it is still the Company's responsibility to ensure that appropriate filings were made and supporting records were retained for examination.

As such, the Company is in violation of the records retention requirements of Regulation 152 (Part 243), section 243.2(a) which requires the retention of this type of record for a period of six calendar years from its creation or until after the filing of the report on examination or the conclusion of the investigation in which the record was subject for review.

It should be noted that only those checks that are over three years old should be included in the Company's abandoned property filings. The Company, however, included in their filings for 2001 (final) and 2002 (preliminary) checks that are just two years old, which means that the filings were one year ahead of their abandoned property-reporting schedule.

It is recommended that the Company comply with the filing requirements of Section 1316 of the Abandoned Property law.

It is further recommended that the Company comply with the record retention requirements of Regulation 152 [New York Codes, Rules, and Regulations (NYCRR) Part 243].

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 2002, based upon the results of this examination:

| | |
|---|---|
| Net premiums written to surplus as regards policyholders | 75% |
| Liabilities to liquid assets (cash and invested assets less investments in affiliates) | 165%* |
| Premiums in course of collection to surplus as regards policyholders | 28% |

The above ratio denoted with an asterisk falls outside the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

The unusual value was caused by the increase in liabilities due to the loss and loss adjustment expense reserve strengthening in 2002 made by the Company.

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

| | Amounts | Ratios |
|---|---|---|
| Losses and loss adjustment expenses incurred | $1,081,933 | 81.0% |
| Other underwriting expenses incurred | 428,777 | 32.1% |
| Net underwriting loss | (174,802) | (13.1%) |
| Premiums earned | $1,335,908 | 100.0% |

G. Minimum Capital Investments

Section 6623(b)(2) of the New York Insurance Law requires the Company to maintain minimum capital investments equal to the following:

"Advance premium corporation in an amount equal to the greater of the minimum capital required by law or the minimum surplus to policyholders required by law for a domestic stock property/ casualty insurance company authorized to transact the same kinds of insurance."

Section 4103(a) puts forth the financial requirements of a stock Insurance Company. Section 4103(a) requires a stock insurance company, licensed for the same lines of business as Colonial Cooperative to have minimum capital of $500,000 and to maintain surplus to policyholders of $800,000.

In view of the above, Colonial Cooperative Insurance Company would be required to have minimum capital investments of $800,000 before investing its funds in any other investments.

Further, Section 1402(b) states in part:

“Not less than sixty percent of the amount of the required minimum capital or surplus to policyholder investments shall consist of the types specified in paragraphs one and two hereof:

(1) Obligations of the United States or of any agency thereof provided such agency obligations are guaranteed as to principal and interest by the United States.

(2) Direct obligations of this state or of any county, district or municipality thereof.”

Based upon the review of the 2002 filed annual statement, it appears that the Company did not satisfy the minimum capital investment requirements inasmuch as Federal Home Loan Mortgage Corporation (FHLMC), Federal National Mortgage Agency (FNMA), Federal Home Loan Bank (FHLB) and Federal Farm Credit Bank securities are not considered eligible in accordance with Section 1402(b) of the NYIL.

Thus, it is recommended that the Company comply with Section 1402(b) of the New York Insurance Law and replace ineligible investments as they mature so as to ensure future compliance with this section of the law.

H. Accounts and Records

1. Custodial Agreement

The Company maintained a custodial agreement with Canandaigua National Bank as of the examination date. A review of the agreement revealed that it did not contain all of the protective covenants and provisions pursuant to the guidelines per the NAIC Financial Condition Examiners Handbook.

It should also be noted that Item 22 of the 2002 Annual Statement General Interrogatories, which addresses this agreement, was answered "yes" thereby indicating conformity of said agreement with the NAIC's Financial Examiners' Handbook requirements.

In view of the above, it is recommended that CCIC revise its custodial agreement to include all the protective covenants and provisions in order to comply with the requirements of the NAIC Financial Condition Examiners Handbook and to Insurance Department guidelines.

It is further recommended that the Company correctly respond to General Interrogatory questions in future statements filed with the Department.

The Company was advised of the agreement's deficiencies and subsequently, in March 2004, provided a revised and executed agreement which contains all of the protective covenants and provisions of the NAIC Financial Condition Examiners Handbook and Insurance Department guidelines.

2. Signature Requirements on Company Checks

The review of the Company's cancelled checks for the month of December 2002, for both checking accounts, revealed that the Company uses a check-imprinting machine to place the facsimile signatures of two officers (President and Vice President) on Company checks. The Company, however, was not able to provide a resolution of the corporation's board of directors regarding the use of such machine nor is there a provision in its by-laws for handling of miscellaneous expenses. Thus, it appears that the Company's usage of a check-signing machine does not satisfy the requirements of Section 6611(a)(4)(C) of the NYIL.

In addition, it is noted that during the examination period the Company entered into a claims service agreement with York Claims Services, Inc. (York), a third party claims administrator. Claims are paid directly by York on behalf of CCIC using funds electronically transferred from the Company's bank. York issues the checks from its own bank account to claimants.

In view of the fact that York Claims Service, Inc, issues and signs checks payable to the Company's loss claimants, it would then appear that CCIC is in violation of Section 6611(a)(4)(C) of the NYIL which states in part that "All checks issued shall be signed by two officers or by one officer upon the written order of another officer, except as otherwise provided by resolution of the corporation's board of directors or in its by-laws for handling of miscellaneous expenses".

In response to the above, the Company has indicated that it has contacted York and will be changing the Company's procedures to ensure that all loss and loss adjustment expense vouchers will be approved by an officer of the Company and that two officers of the Company will sign checks for loss and loss expense-related disbursements. CCIC further indicated that it will be preparing for the necessary board resolutions and setting up the necessary banking requirements in the near future.

Nevertheless, it is recommended that the Company comply with Section 6611(a)(4)(C) of the NYIL with regard to having the required number of officers' signatures on all Company checks. It is noted that a similar recommendation was included in the two previous reports on examination.

3. Agents' Balances or Uncollected Premiums Lines in the Annual Statement

The Company did not report a balance on Line 10.2 (Installments booked but deferred and yet due) in the filed 2002 annual statement as the entire uncollected premiums were reported on Line 10.1 (Premiums in course of collection). However, the Company's Gross Outstanding Receivables Report (AR066 report) which shows the details of uncollected premiums indicates an installment not billed amount of $1,208,649 (88% of the net admitted uncollected premiums). This balance should have been reported on Line 10.2 on page 2 of the annual statement. Due to this incorrect reporting, IRIS ratio number 9 - Gross Agents Balances to Policyholders was inaccurately calculated since the Line 10.1 balance is used to calculate this ratio.

In view of the above, it is recommended that the Company correctly fill out the uncollected premium lines in all future statements filed with the Department.

4. <u>Imprest Account with York Claims Services, Inc. (CCIC's Third Party Administrator)</u>

As indicated on Item 2 above, the Company entered into a Claims Service Agreement with York Claims Service, Inc. (York) for which York acted as CCIC's claims service provider. The agreement, in part, calls for individual loss payments in excess of $25,000 to be separately funded by the Company to York, prior to payment of such loss.

It is noted that in October 2002, funds amounting to $475,000 were transferred to York for payment of one specific claim. However, this amount was not immediately paid to the claimant due to some unresolved issues related with the claimant. It is noted that the funds remained in York's bank account for 13 months until it was transferred back to the Company's account in November 2003. The Company did not receive interest on the $475,000 because under the terms of the agreement all interest earned, if any, as a result of such Imprest Account funds will belong to York. Had the Company immediately requested for the return of the fund when it was apparent that it has not been paid to the claimant due to unresolved issues, the Company could have benefited and earned the interest.

In light of the fact that the Company will be changing its check writing procedures and will take back the authority in the issuance of claim checks, event such as this should not happen in the future. Nonetheless, it is recommended that the Company ensure that it has control of its assets at all times.

5. Approval of Expense Vouchers and Use of Company Credit Cards

The review of the Company's expense vouchers revealed that they appear to be in compliance with the stipulations of Section 1217 of the NYIL, which requires companies to evidence distributions exceeding $100 by a detailed voucher signed by or on behalf of the payee. It was noted, however, that in a few instances only the person submitting the voucher was signing it and no approval of an officer was required. Accordingly, it is recommended that the Company ensure that all future vouchers are approved by an authorized officer of the Company as this is a good internal control.

In response to the above, the Company has indicated that they were aware of the deficiencies in the voucher approval process and had taken action regarding this matter. It was further indicated that all expense vouchers are now reviewed and approved by an officer of the Company.

The review of the Company's credit card statements for the year 2002 showed a number of items that did not appear to be Company related expenses. The Company has indicated that these amounts were subsequently reimbursed by the employees to the Company. The examiner's further verification confirmed such statement. Nevertheless, it is recommended that management establishes and abides by written procedures pertaining to employees' use of Company credit cards.

In response to the above, the Company has provided a written corporate credit card policy dated March 29, 2004 which indicates in part that corporate credit cards are to be used for Company business only, with certain exception.

6. Fidelity Bond and Other Insurance Coverage

As of December 31, 2002 the Company has fidelity insurance coverage in the amount of $75,000 with Hartford Fire Insurance Company. Based on the examiner's recalculation in accordance with the guidelines set forth in the NAIC Financial Condition Examiners Handbook, this amount is below the NAIC's suggested minimum of between $150,000 to $175,000 for a company of CCIC's size.

It is, therefore, recommended that the Company calculate and maintain the appropriate amount of fidelity bond as set forth in the NAIC Examiners Handbook.

The Company's Directors and Officers Liability Insurance policy was also reviewed for conformity with the minimum retention and coinsurance guidelines prescribed by Regulation 110 (NYCRR Part 72). It is noted that the policy does not include a $3,000 individual and $30,000 aggregate retention required for companies with assets greater than $5 million up to $10 million. The policy also lacked the minimum coinsurance percentage of 0.3% of the first $1,000,000 of coverage. As indicated in the balance sheet section of this report, the Company's net admitted assets per the 2002 filed annual statement were $6,131,242.

In view of the above, it is recommended that the Company comply with the requirements of Regulation 110 henceforth and maintain a directors and officers' liability insurance policy that contains the required appropriate retention amount and coinsurance percentage.

7. Allocation of Expenses

The review of the Company's allocation of expenses to the major categories shown per Underwriting & Investment Exhibit - Part 3 of the 2002 filed annual statement revealed that the worksheet showing the percentages being used to allocate expenses dates back to time studies completed during the course of the prior Department examination (as of December 31, 1997). The prior examination included a recommendation that management establishes and maintains written documentation supporting the allocation of each expense category to the major expense groups as required by Department Regulation 30.

Per the review of Regulation 30 Part 107.4(d) as well as Part 109, it would appear that the basis of expense allocation should be compiled or calculated at least annually, unless changes in Company operations warrant increased frequency. The Company should also be maintaining documentation sufficient to support its allocation percentages.

In view of the fact that there was no current support for expense allocation percentages being used, it is again recommended that the Company comply with the requirements of Regulation 30, henceforth.

8. CPA Contract

The Company retains Sperry, Cuono, Holgate & Churchill, (SCH&C) C.P.A.'s, P.C. as its independent certified public accountant for the period under examination (1998 – 2002). The review of CCIC's contract with SCH&C revealed that the contract does not fully comply with the requirements specified in Section 89.2 of Regulation 118 of the New York Codes Insurance Regulations (as amended effective May 9, 2001).

Section 89.2 states that:

> "Every insurer subject to this Part shall retain an independent Certified Public Accountant (CPA) who agrees by written contract with such insurer to comply with the provisions of section 307(b) of the Insurance Law, this Part and the Code of [Ethics and] Professional [Standards] Conduct adopted by the American Institute of Certified Public Accountants (AICPA). Such contract must specify that:
>
> > (a) on or before [June $30^{th}$] May $31^{st}$, the CPA shall provide an audited financial statement of such insurer and of any subsidiary required by section 307(b)(1) of the Insurance Law [and] together with an opinion on the financial statements of such insurer and any such subsidiary for the prior calendar year and an evaluation of the insurer's and any such subsidiary's accounting procedures and internal control systems as are necessary to the furnishing of the opinion;
> >
> > (b) any determination by the CPA that the insurer has materially misstated its financial condition as reported to the superintendent or that the insurer does not meet minimum capital [and] or surplus to policyholder requirements set forth in the Insurance Law shall be given by the CPA, in writing, to the superintendent within 15 calendar days following such determination; and
> >
> > (c) the workpapers and any communications between the CPA and the insurer relating to the audit of the insurer shall be made available for review by the superintendent at the offices of the insurer, at the Insurance Department or at any other reasonable place designated by the superintendent. The CPA must retain for review such workpapers and communications [for a period of not less than five (5) years] in accordance with the provisions of Part 243 of this Title (Regulation 152). More specifically, such workpapers and communications must be retained by the CPA for the period specified in sections 243.2(b)(7) and (c) of this Title. For the purposes of this subdivision, the workpapers and communications shall be deemed to have been created on the date the filing required by section 89.2(a) of this Part was submitted to the superintendent."

(Underlined matters are new or were added; matters in [bracket] were deleted.)

It is therefore recommended that the Company's contract with SCH&C, CPA's be revised to comply with the requirements of Department Regulation 118.

## I. Subsequent Events

The Company commenced an arbitration proceeding against its former pooling partner, First Financial Insurance Company (FFIC). The arbitration was filed to recover FFIC's share of operating expenses during the run-off of the business relative to the pooling and reinsurance agreement between the parties that was terminated effective December 31, 2003.

It is noted in CCIC's quarterly statement as of March 31, 2004 that the amount of expenses in dispute is $311,711.

# 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, 2002 and as reported by the Company:

| Assets | Examination Assets | Examination Assets Not Admitted | Examination Net Admitted Assets | Company Net Admitted Assets | Surplus Increase (Decrease) |
|---|---|---|---|---|---|
| Bonds | $320,947 | $0 | 320,947 | $320,947 | 0 |
| Cash and short-term investments | 3,023,998 | 0 | 3,023,998 | 3,023,998 | 0 |
| Other invested assets | 16,168 | 0 | 16,168 | 16,168 | 0 |
| Subtotals, cash and invested assets | $3,361,113 | $0 | $3,361,113 | $3,361,113 | $ 0 |
| Premiums and agents' balances in course of collection | 164,337 | 18,092 | 146,245 | 1,368,197 | (1,221,952) |
| Premiums, agents' balances and installments booked but deferred and not yet due | 1,208,649 | | 1,208,649 | | 1,208,649 |
| Reinsurance recoverables on loss and loss adjustment expense payments | 728,409 | 0 | 728,409 | 728,409 | 0 |
| Interest, dividends and real estate income due and accrued | 15,556 | 0 | 15,556 | 15,556 | 0 |
| Receivable from parent, subsidiaries and affiliates | 579,184 | 0 | 579,184 | 239,413 | 339,771 |
| Equities and deposits in pools and associations | 13,992 | (74) | 14,066 | 14,066 | 0 |
| Aggregate write-ins for other than invested assets | | | | | |
| Imprest account with TPA | 404,488 | 0 | 404,488 | 404,488 | 0 |
| Total assets excluding protected cell assets | $6,475,728 | $18,018 | $6,457,710 | $6,131,242 | $326,468 |
| Total Assets | $6,475,728 | $18,018 | $6,457,710 | $6,131,242 | $326,468 |

| Liabilities, surplus and other funds | Examination | Company | Surplus Increase (Decrease) |
|---|---|---|---|
| Losses and loss adjustment expenses | $726,680 | $726,680 | $0 |
| Commissions payable, contingent commissions and other similar charges | 1,180 | 1,180 | 0 |
| Other expenses (excluding taxes, licenses and fees) | 5,143 | 5,143 | 0 |
| Taxes, licenses and fees (excluding federal and foreign income taxes) | 4,690 | 0 | (4,690) |
| Unearned premiums | 213,687 | 213,687 | 0 |
| Ceded reinsurance premiums payable (net of ceding commissions) | 3,702,587 | 3,362,816 | (339,771) |
| Amounts withheld or retained by company for account of others | 1,163,627 | 1,168,317 | 4,690 |
| Aggregate write-ins for liabilities | 71,721 | 71,721 | 0 |
| Total liabilities excluding protected cell liabilities | 5,889,315 | 5,549,544 | (339,771) |
| Total liabilities | $5,889,315 | $5,549,544 | (339,771) |
| | | | 0 |
| Aggregate write-ins for special surplus funds | | | |
| Special contingent surplus | $390,803 | $388,714 | 2,089 |
| Surplus note | 270,200 | 270,200 | |
| Unassigned funds (surplus) | (92,608) | (77,216) | (15,392) |
| Surplus as regards policyholders | $568,395 | $581,698 | (13,303) |
| Total liabilities, surplus and other funds | $6,457,710 | $6,131,242 | |

Notes:

1. The Company has Section 1307 loans payable in the amount of $270,200 and accrued interest thereon totaling $843,142 as of December 31, 2002. These loans, in the form of notes, bear an interest rate of 8.5% on $70,200 issued in 1976 and 16% on $200,000 issued in 1981. Pursuant to the provisions of Section 1307 of the New York Insurance Law, said amounts shall not form a part of the legal liabilities of the insurer, but shall be reported in a footnote to all financial statements. Furthermore, repayment of the loans and the interest thereon shall only be made of out free and divisible surplus of the Company and only with the approval of the Superintendent.

2. The Internal Revenue Service did not audit the Company's Federal Income Tax returns during the period under examination. There are no audits currently in progress. 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 Exhibit

Surplus as regards policyholders increased $99,852 during the five-year examination period January 1, 1998 through December 31, 2002, detailed as follows:

| | | |
|---|---|---|
| Underwriting Income | | |
| Premiums earned | | $1,335,908 |
| Deductions: | | |
| Losses and loss adjustment expenses incurred | $1,081,933 | |
| Other underwriting expenses incurred | 428,777 | |
| Total underwriting deductions | | 1,510,710 |
| Net underwriting gain or (loss) | | ($174,802) |
| Investment Income | | |
| Net investment income earned | $222,622 | |
| Net realized capital gain | 0 | |
| Net investment gain or (loss) | | $222,622 |
| Other Income | | |
| Net gain or (loss) from agents' or premium balances charged off | ($107,472) | |
| Finance and service charges not included in premiums | 150,465 | |
| Aggregate write-ins for miscellaneous income | (217,696) | |
| Total other income | | ($174,703) |
| Net income before dividends to policyholders and before federal and foreign income taxes | | ($126,883) |
| Dividends to policyholders | | 0 |
| Net income after dividends to policyholders but before federal and foreign income taxes | | ($126,883) |
| Federal and foreign income taxes incurred | | 0 |
| Net Income | | ($126,883) |

| | Gains in Surplus | Losses in Surplus | |
|---|---|---|---|
| Surplus as regards policyholders per report on examination as of December 31, 1997 | | | $468,542 |
| Net income | | $126,883 | |
| Net unrealized capital gains or (losses) | $13,668 | | |
| Change in nonadmitted assets | 213,070 | | |
| Aggregate write-ins for gains and losses in surplus | 0 | 2 | |
| Net increase (decrease) in surplus | | | 99,853 |
| Surplus as regards policyholders per report on examination as of December 31, 2002 | | | $568,395 |

## 4. AGENTS' BALANCES OR UNCOLLECTED PREMIUMS

The examination balance of $1,354,894 is $13,303 less than the $1,368,197 balance reported by the Company as of the examination date.

The examination change represents an overstatement of the general ledger balance for the agency billed portion of uncollected premiums. The Company's Gross Outstanding Receivables Report for account current (agency bill) policies shows a total of $13,176. The agency bill general ledger balances, however, show a total of $26,479; hence, the $13,303 examination change.

## 5. RECEIVABLES from PARENT, SUBSIDIARIES and AFFILIATES

The examination asset of $579,184 is $339,771 more than the $239,413 balance reported by the Company as of the examination date.

The examination change is a reclassification from Ceded Reinsurance Premiums Payable account that relates to the Company's reinsurer's share of agents' commission amounting to $339,771. As noted in the foregoing Reinsurance section, CCIC participates in a reinsurance and pooling arrangement with FFIC as of the examination date. As such, the $339,771 represents FFIC's 95% share of agents' commission for the fourth quarter of 2002. (Refer to Item 8 - Ceded reinsurance premiums payable further herein.)

## 6. LOSSES and LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of $726,680 is the same as the balance reported by the Company as of December 31, 2002. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Companies internal records and in its filed annual statements.

During the review of the above-captioned accounts, the following were noted:

i. A variance of $62,000 was noted between Schedule P and U&I Exhibit for Loss Adjustment Expenses Paid with the Schedule P amount being less than the U&I Exhibit amount. Per the Company's response, they are unable to provide an explanation for the above difference as the 2002 Schedule P was prepared by an outside consultant.

ii. In accordance with annual statement instructions, the Company is required to provide claims count data for claims reported, claims outstanding, and claims closed with payment in Schedule P of its filed annual statement. During the review of losses, data anomalies were noted in the claims count data reported in Schedule P of the Company's filed 2002 annual statement.

The data irregularities for the number of claims reported – direct & assumed noted in the Company's Schedule P for the year ended December 31, 2002 for CMP business (CCIC's predominant line of business) were noted. For certain years (1994 through 1999) the cumulative number of claims reported decreased from year end 2001 to year end 2002.

Per the Company's response, it appears that the differences are due to manual calculation errors; however, the Company was unable to provide any schedules or worksheets to support this statement and therefore could not provide more detailed reasons for the errors noted.

In view of the above, it is recommended that the Company provide accurate claims count data and that the Schedule P be accurately filled out in all future statements filed with the Department.

## 7. TAXES, LICENSES and FEES

The Company reported no liability under this caption as of the examination date. This examination has established the captioned liability in the amount of $4,690.

In accordance with the 2002 Annual Statement Instructions, the above-captioned account should include incurred but unpaid investment and underwriting taxes, licenses and fees.

It is noted that the Company incorrectly included an accrual for the New York State Fire Fee under the liability caption "Amounts Withheld or Retained by the Company for Account of Others" of the 2002 filed Annual Statement instead of the above-captioned account. This reclassification has no surplus effect. (Refer to Item 9 – Amounts Withheld or Retained for Account of Others.)

It is recommended that the Company correctly classify annual statement accounts in accordance with the NAIC Annual Statement Instructions.

## 8. CEDED REINSURANCE PREMIUMS PAYABLE

The examination liability of $3,702,587 is $339,771 more than the $3,362,816 balance reported by the Company as of the examination date.

SSAP #62, paragraph 41 of the Accounting Practices and Procedures Manual states in part that "Ceded reinsurance premiums payable (net of ceding commission) shall be classified as a liability". Paragraph 50 of this SSAP also states in part that "Commissions receivable on reinsurance ceded business shall be included as an offset to Ceded Reinsurance Balances Payable."

It is noted that the $339,771 commission expenses booked as an offset to Ceded Reinsurance Premiums Payable are not ceding commission but rather FFIC's share of agents' commissions for the fourth quarter of 2002. Accordingly, this amount is being reclassified to Receivable from Parent, Subsidiaries, and Affiliates. (Refer to the foregoing Item 5 - Receivable from Parent, Subsidiaries, and Affiliates.)

It should also be noted that the reinsurance and pooling contract between the Company and FFIC does not call for any ceding commission to CCIC.

It is recommended that the Company comply with SSAP #62 of the Accounting Practices and Procedures Manual and not record agents' commission as an offset to Ceded Reinsurance Premiums Payable account.

## 9. AMOUNTS WITHHELD or RETAINED for ACCOUNT of OTHERS

The examination liability of $1,163,627 is $4,690 less than the $1,168,317 balance reported by the Company as of the examination date.

The examination change relates to the reclassification of the above amount to the liability account "Taxes, Licenses and Fees". This is due to the Company incorrectly including an accrual for the New York State Fire Fee under this liability caption in the 2002 filed Annual Statement. It should be noted that this reclassification has no surplus effect. (Also refer to Item 7 - Taxes, Licenses and Fees above.)

## 10. 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.

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.

Sales and advertising

i. Advertising

It should be noted that majority of the Company's advertising expenses appeared to be promotional in nature. However, for those items that corresponded to advertising, copies of the actual advertisements were not available for review. As such, it is recommended that the Company maintain copies of all advertisements so that compliance with Sections 1313 and 2403 of the New York Insurance Law can be determined.

ii. Agents

The prior report on examination included a recommendation that the Company ensure that all of the requirements of Department Regulation 90 are complied with. Based on the current examination's review, the Company again has not complied with this recommendation.

The ten termination letters reviewed all included the 30 days prior notice as well as redlining notices that were the subject of the prior report's comment.

Section 218.5 of Regulation 90 states in part:

"The following notice shall be clearly and prominently set out in boldface type on the front …, so that it draws the reader's attention on all notices of refusal to issue, cancellation or nonrenewal, except where the cancellation is for nonpayment of premium; and on all notices of termination of agents' and brokers' contracts or accounts…"

> **"If you have any questions in regard to this termination, please contact the company's representative at (company phone number, name of company representative, company address)."**

It is noted, however, that nine of the ten notices reviewed excluded the above paragraph.

Furthermore, the review of the notices revealed that the reasons for agent termination were not specific; therefore, violating Section 218.4(a) of Regulation 90, which states in part that:

> "All notices to agents or brokers that their contract or account is to be terminated, in whole or in part, shall state the specific reason or reasons for such termination. A specific reason shall not be an unsupported general statement, such as 'insufficient volume' or 'poor loss ratio.' ".

It is noted that the reason given states consistently on nine of the ten letters reviewed, that "…termination is based upon factors which include little or no written premium volume with our company, poor loss ratios, lack of activity in the production of new business, and other relevant agency/ company relationship factors which might apply."

The above statement or reason is an unsupported general statement and should have instead specified what the Company's expectations were and how each of the terminated agents falls short.

In view of the above, it is again recommended that the Company comply with all the provisions of Regulation 90 (NYCRR Part 218) henceforth.

Claims and complaint handling

i. <u>Regulation 64 Compliance</u>

The Company's claim files were reviewed for compliance with the provisions of Regulation 64 (NYCRR Part 216). The review revealed the following:

Nine of the forty-one claim files reviewed lacked supporting documentation. The files were recreated since the Company was not able to locate the file. The Company has indicated that York, its claims service provider could not locate the original of these nine files as such they were recreated from adjusters' notes.

Section 216.11 of Regulation 64, requires that insurers maintain within each claim file all communications and transactions, notes and workpapers relating to the claim.

In addition, Regulation 152 (NYCRR Part 243) provides the minimum time for record retention of customer records by insurers. The retention requirements for claim files being (1) six calendar years after all elements of the claim are resolved and the file is closed, or (2) until after the filing of the report of examination in which the claim file was subject for review.

In view of the above, it is recommended that the Company maintain all documentation in its claim files in accordance with the provisions of Section 216.11 of Regulation 64 and Regulation 152, henceforth.

ii. Complaints

Circular Letter 1978-11 requires that insurers operating within the state establish an internal department specifically designated to investigate and resolve complaints filed by consumers with the New York Insurance Department's (NYSID) Consumer Services Bureau and to take action necessitated by investigation findings. The Company's Vice President is designated to be responsible for this function. This circular letter also requires the Company to maintain an ongoing central log to register and monitor all complaint activity. As indicated in the circular letter, the log should be kept in columnar form and list the eleven items as stated therein.

The review of the Company's 1999 through 2002 complaint logs for compliance with the requirements of Circular Letter No. 11 (1978) revealed that five of the eleven columns / items were not included, as follows:

1. The person in the company with whom the complainant has been dealing.
2. The date of internal referral.
3. Chronology of further contacts with the New York State Insurance Department.
4. The result of the complaint investigation and the action taken.
5. Remarks about internal remedial action taken as a result of the investigation.

It is therefore recommended that the Company comply with the requirements of Circular Letter 1978-11 and going forward maintain a complaint log that encompasses the eleven topics required in this circular letter.

In response to the above, the Company has indicated that its complaint log will be re-worked so as to include and account for the eleven topics noted in the aforementioned circular letter.

iii. Cancellations and Non-renewals Notices

Section 3426(e)(2) of the New York Insurance Law states in part:

"A nonrenewal notice…, a conditional renewal notice…, and the second notice… shall contain the specific reason or reasons for nonrenewal or conditional renewal, …, and describe in plain and concise terms the nature of any other proposed changes…" (Emphasis added.)

The review of non-renewals revealed that four of the nineteen policies sampled, the Company issued non-renewal notices that did not contain the specific reason for non-renewal which appears to be in violation of the above section of the law.

It is therefore recommended that the Company comply with the requirements of Section 3426(e)(2) of the NYIL, henceforth, and include the specific reason on non-renewal notices sent to all insureds.

## 11. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained 18 recommendations as follows (page numbers refer to the prior report):

| ITEM | | PAGE NO. |
|---|---|---|
| A. | Management | |
| | (i) It was recommended that Director Theodore J. Rupley either improve his attendance at board meetings or that the policy-holders replace him with an individual who will be more active in the affairs of the Company. | 5 |
| | The above-named individual was no longer a director as of February 1999. However, during the examination period two directors have attendance record of less than 50% of the meetings they were eligible to attend. Thus, a similar comment is contained in this current report on examination. (Refer to Item 2.A.) | |
| | (ii) It was recommended that the Company adhere to all the provisions of its by-laws, henceforth. | 5 |

The Company did not comply with this recommendation. A similar recommendation is included in the current report on examination. (Refer to Item 2.A.)

(iii) It was recommended that the Company adhere to all the provisions of Section 708 of the New York Business Corporation Law, henceforth. 6

The Company's charter and by-laws was amended in March 1999 to allow the use of a conference telephone at board or committee meetings. Hence, the Company complied with this recommendation.

B. Reinsurance and Pooling Agreements 9-10

(i) It was noted that the Company is a party to arbitration proceedings related to the Pooling and Reinsurance Agreement between itself and Colonial Indemnity Insurance Company.

This litigation was settled in April 2002. The Company paid $37,500 as settlement amount in the arbitration case.

C. Significant Operating Ratios 12

(i) It was recommended that the Company take the steps necessary to ensure that its administrative expense ratio meets the 42.5% statutory limitation each year, unless lawfully exempted therefrom. It is noted that a similar recommendation was included in the two previous reports on examination.

The Company has complied with this recommendation. The Company's administrative expense ratio for all years under examination (1998-2002) was below 42.5%.

D. Allocation of Expenses 13

(i) Management was directed to establish and maintain written documentation supporting the allocation of each expense category to the major expense groups as required by Department Regulation 30. It was noted that a similar recommendation was included in the previous report on examination.

The Company again has not complied with this recommendation. A similar comment is contained in the current report on examination. (Refer to Item 2.H.7.)

E. Signature Requirements on Company Checks 14

(i). It was recommended that, henceforth, the Company comply with

Section 6611(a)(4)(C) of the New York Insurance Law with regard to having the required number of officers' signatures on all Company checks. A similar recommendation was included in the previous report on examination.

The Company again has not complied with this recommendation. A similar recommendation is contained in the current report on examination. (Refer to Item 2.H.2.)

F. <u>Minimum Capital Investments</u> 15

(i). It was recommended that the Company not invest its funds in any other investments until it maintains $800,000 of minimum capital investments, as required by Section 6623(b)(2) of the New York Insurance Law.

The Company has complied with this recommendation. However, a recommendation regarding the type of securities to be maintained as minimum capital investments per the provisions of Section 1402(b) of the NYIL is contained in the current report on examination. (Refer to Item 2.G.)

G. <u>Employment Agreement with Kenneth Pangburn</u> 17

(i) It appears that the Company entered into an employment agreement with Mr. Kenneth Pangburn, which attempts to usurp the rights of the board of directors. It is recommended that the Company refrain from entering into any such contracts in the future.

The Company has represented that no such employment contract was entered into with any officer of the Company during the examination period.

H. <u>Payments to Consultants</u>

(i). It is recommended that the Company comply with Section 1217 of the New York Insurance Law, henceforth. 18

The review of the Company's expense vouchers revealed that they appear to be in compliance with the stipulations of Section 1217 of the NYIL. Hence, the Company has complied with this recommendation.

(ii). It is recommended that the Company seek reimbursement of all expenses paid by Colonial Cooperative, during the period October 10, 1997 through December 31, 1997, to Thomas Derella, Phil Doris, Patricia Jordan, Helena Kanner and Kenneth Pangburn. 19

Since the issue of no authorization to pay the above consultants' expenses was raised in the prior report, the board authorized, in its August 13, 1998 meeting, to pay the expenses incurred by the consultants for the fourth quarter of 1997.

(iii) It is recommended that, henceforth, the directors of the Colonial Cooperative Insurance Company remain mindful of their fiduciary responsibilities to the Company and its policyholders, as set forth in Section 717 of the New York Business Corporation Law. In addition, the policyholders should replace any director of the Company who cannot or does not fulfill his/her duties in good faith and with that degree of care which an ordinarily prudent person in a like position would use under similar circumstances. 19-20

The Company has complied with this recommendation.

I. <u>Accounting and Records; Equity in the "Fair Plan"</u> 20

(i) It is recommended that the Company reflect its equity in the "Fair Plan" up through the appropriate statement date in all future financial statements filed with this Department.

The Company has complied with this recommendation.

J. <u>Accounting and Records; Written Disaster and Recovery Plan</u> 20

(i) It is recommended that the Company develop a written disaster/backup and recovery plan in order to strengthen its electronic data processing department controls.

During the examination period, the Company developed a written disaster/backup and recovery plan; hence, the Company has complied with this recommendation.

K. <u>Receivable from Parent, Subsidiaries and Affiliates</u> 25

(i) It is recommended that in future financial statements filed with this Department, receivables from affiliates or former affiliates that are in dispute, be shown as not admitted assets, inasmuch as such receivables are not available for the payment of losses and claims, as required by Section 1301(a)(21) of the New York Insurance Law.

During the examination period (1998 – 2002), there were no receivables from affiliates or former affiliates that were in dispute. Hence, it appears that the Company has complied with this recommendation.

L. <u>Cash Surrender Value of Life Insurance</u> 26

(i) It is recommended that the Company surrender the life insurance policies it has on Helena Kanner and Kenneth Pangburn.

The Company has indicated that the above-noted policies were surrendered in December 1998 and July 1999.

M. Market Conduct Activities

(i) It is recommended that when sending out notices of termination of agents' or brokers' contract or accounts, the Company ensure that all of the requirements of Department Regulation 90 are complied with, henceforth. It is noted that a similar recommendation was included in the prior report on examination. 28

The Company again has not complied with this recommendation. A similar recommendation is contained in this report on examination. (Refer to Item 10.A.ii.)

(ii) It is recommended that the Company comply with all the requirements of Department Regulation 96, henceforth. It is noted that a similar recommendation was included in the prior report on examination. 29

The Company has complied with this recommendation for part of the examination period. It is noted that the above-indicated regulation was amended effective September 1999 and most recently in June 2002. Due to these recent amendments, the Company was again found to be not in compliance with a particular section of this regulation. Nevertheless, since the Company, during the course of the examination, has corrected their procedures to allow compliance with the requirements of Regulation 96, this recommendation will not be repeated.

## 12. SUMMARY OF COMMENTS AND RECOMMENDATIONS

| ITEM | | | PAGE NO. |
|---|---|---|---|
| A. | Management | | |
| | i. | It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced. | 5 |
| | ii. | It is recommended that the Company fully comply with section 1411(a) of the NYIL and that the board exercise due care in approving the investment transactions. | 5 |
| | iii. | It is recommended that the Company adhere to the provisions of Section 6603(a)(5)(E) of the New York Insurance Law and ensure the number of directors is not less than nine at all times. | 6 |
| | iv. | It is again recommended that the Company adhere to all the provisions of its by-laws. | 6 |
| B. | Reinsurance | | |
| | i. | It is recommended that the Company comply with Sections 1308(e) and 1505(d)(2) of the NYIL, henceforth and that the Company submit to the Department for approval all reinsurance agreements and amendments thereto . | 14 |
| | ii. | It is recommended that any future reinsurance contracts the Company enters into include an arbitration clause and indicate that any arbitration should take place within New York State. | 17 |
| | iii. | It is recommended that any future reinsurance contracts the Company enters into include the required language in the offset provision in compliance with Section 7427 of the New York Insurance Law. | 17 |

C. Holding Company Matters

i. It is recommended the Company comply with Circular Letter No. 33 (1979) and that a written tax allocation agreement approved by the Company's board of directors be in place in order to assure fair and equitable inter-company transactions. 21

ii. It is recommended that the Company comply with the provisions of Regulation 53 (NYCRR Part 81-1) by submitting the necessary Regulation 53 filings to the Department which should include a certified financial statement of CGA. 21

D. Abandoned Property Law

i. It is recommended that the Company comply with the filing requirements of Section 1316 of the Abandoned Property law. 22

ii. It is further recommended that the Company comply with the record retention requirements of Regulation 152 (NYCRR Part 243). 23

E. Minimum Capital Investments

It is recommended that the Company comply with Section 1402(b) of the New York Insurance Law and replace ineligible investments as they mature so as to ensure future compliance with this section of the law. 25

F. Accounts and records

i. It is recommended that CCIC revise its custodial agreement to include all the protective covenants and provisions in order to comply with the requirements of the NAIC Financial Condition Examiners Handbook and to Insurance Department guidelines. 25

ii. It is further recommended that the Company correctly respond to General Interrogatory questions in the annual statement. 25

iii. It is recommended that the Company comply with Section 6611(a)(4)(C) of the NYIL with regard to having the required number of officers' signatures on all Company checks. It is noted that a similar recommendation was included in the two previous reports on examination. 27

iv. It is recommended that the Company correctly fill out the uncollected premium lines in all future statements filed with the Department. 28

v. It is recommended that the Company ensure that it has control of its assets at all times. 28

| | | |
|---|---|---|
| vi. | It is recommended that the Company ensure that all future vouchers are approved by an authorized officer of the Company as this is a good internal control. | 29 |
| vii. | It is recommended that management establishes and abides by written procedures pertaining to employees' use of Company credit cards. | 29 |
| viii. | It is recommended that the Company calculate and maintain the appropriate amount of fidelity bond as set forth in the NAIC Examiners Handbook. | 30 |
| ix. | It is recommended that the Company comply with the requirements of Regulation 110 (NYCRR Part 72), henceforth, and maintain a directors and officers' liability insurance policy that contain the required appropriate retention amount and coinsurance percentage. | 31 |
| x. | It is again recommended that the Company comply with the requirements of Regulation 30, henceforth. | 31 |
| xi. | It is recommended that the Company's contract with SCH&C, CPA's be revised to comply with the requirements of Department Regulation 118. | 33 |

G. Loss and Loss Adjustment Expenses

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|---|---|---|
| | It is recommended that the Company provide accurate claims count data and that the Schedule P be accurately filled out in all future statements filed with the Department. | 40 |

H. Taxes, Licenses and Fees

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| | It is recommended that the Company correctly classify annual statement accounts in accordance with the NAIC Annual Statement Instructions. | 40 |

I. Ceded Reinsurance Premiums Payable

| | | |
|---|---|---|
| | It is recommended that the Company comply with SSAP #62 of the Accounting Practices and Procedures Manual and not record agents' commission as an offset to Ceded Reinsurance Premiums Payable account. | 41 |

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|---|---|---|---|
| J. | Sales and Advertising | | |
| | i. | It is recommended that the Company maintain copies of all advertisements so that compliance with Sections 1313 and 2403 of the New York Insurance Law can be determined. | 43 |
| | ii. | It is again recommended that the Company comply with all the provisions of Regulation 90 (NYCRR Part 218) henceforth. | 44 |
| K. | Claims and complaint handling | | |
| | i. | It is recommended that the Company maintain all documentation in the claim files in accordance with the provisions of Section 216.11 of Regulation 64 and Regulation 152, henceforth. | 45 |
| | ii. | It is recommended that the Company comply with the requirements of Circular Letter 1978-11 and going forward maintain a complaint log that encompasses the eleven topics required in this circular letter. | 46 |
| | .ii. | It is recommended that the Company comply with the requirements of Section 3426(e)(2) of the NYIL, henceforth, and include the specific reason on non-renewal notices sent to all insureds. | 47 |

Respectfully submitted,

__________________________
Fe Rosales, CFE
Senior Insurance Examiner

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

Fe Rosales, being duly sworn, deposes and says that the foregoing report, subscribed by her, is true to the best of her knowledge and belief.

__________________________
Senior Insurance Examiner

Subscribed and sworn to before me

this__________ day of ____________________, 2006.

Respectfully submitted,

/S/

Fe Rosales, CFE
Senior Insurance Examiner

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

Fe Rosales, being duly sworn, deposes and says that the foregoing report, subscribed by her, is true to the best of her knowledge and belief.

/S/

Senior Insurance Examiner

Subscribed and sworn to before me

this 19th day of August, 2004.

Laura L Mortefolio

LAURA L. MORTEFOLIO
Notary Public, State of New York
#01MO5023417
Qualified in Columbia County
Commission Expires 2/7/06

*Appointment No* *22093*

*STATE OF NEW YORK*
*INSURANCE DEPARTMENT*

*I,* GREGORY V. SERIO *, Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:*

**Fe Rosales**

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

**Colonial 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 Albany,*

*this* 29th *day of* *September, 2003*

STATE OF NEW YORK ★ SUPERINTENDENT OF INSURANCE ★

EXCELSIOR

GREGORY V. SERIO
*Superintendent of Insurance*