

REPORT ON EXAMINATION

OF THE

SECURITY MUTUAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2010

DATE OF REPORT

FEBRUARY 17, 2012

EXAMINER

FRANK P. SCHIRALDI

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NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Benjamin M. Lawsky
Superintendent

February 17, 2012

Honorable Benjamin M. Lawsky
Superintendent of Financial Services
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 30702 dated April 6, 2011, attached hereto, I have made an examination into the condition and affairs of Security Mutual Insurance Company as of December 31, 2010, and submit the following report thereon.

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

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

The examination was conducted at the Company’s home office located at 2417 North Triphammer Road, Ithaca, NY 14850.

1. SCOPE OF EXAMINATION

The Department has performed a single state examination of Security Mutual Insurance Company. The previous examination was conducted as of December 31, 2005. This examination covered the five-year period from January 1, 2006 through December 31, 2010. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

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

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process. The examiners also relied upon audit work performed by the Company’s independent public accountants when appropriate.

This examination report includes a summary of significant findings for the following items as called for in the Handbook:

- Significant subsequent events
- Company history
- Corporate records
- Management and control
- Territory and plan of operation
- Growth of Company
- Loss experience
- Reinsurance
- Accounts and records
- Statutory deposits
- Financial statements
- Summary of recommendations

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

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

2. DESCRIPTION OF COMPANY

The Company was organized in 1887, as the Tompkins County Co-operative Fire Insurance Company for the purpose of transacting business as a co-operative fire insurance corporation in Tompkins County, New York.

Subsequently, the territorial limits of the Company were extended to include all of the Counties of this State, and wherever authorized by law, any other States of the United States of America and the District of Columbia.

In 1935, the Company changed its name to the Tompkins Co-operative Fire Insurance Company.

In June 1957, the Company absorbed by merger the West Seneca Mutual Fire Insurance Association.

On February 7, 1964, the Company absorbed by merger the Security Mutual Fire Insurance Company of Delhi, New York and, concurrently, changed its name to Security Mutual Fire Insurance Company. On December 31, 1964, the Company absorbed by merger the Canton Co-operative Fire Insurance Company, Canton, New York.

Effective February 18, 1975, the Company adopted its current title.

On April 27, 2004, pursuant to the provisions of Section 1307 of the New York Insurance Law, the Department approved the Company's request to issue a floating rate surplus note with a principal amount of \$5,000,000. The surplus note was issued on May 12, 2004, with a due date of 2034. The Department has approved quarterly payments of interest in each quarter of the examination period.

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 thirteen members. The board meets four times during each calendar year. At December 31, 2010, the board of directors was comprised of the following twelve members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
W. David Banfield Ithaca, NY	Retired
Robert J. Clune Ithaca, NY	Attorney, Williamson, Clune and Stevens
Delbert L. Hall Dryden, NY	Secretary and Treasurer, Security Mutual Insurance Company
Joan H. Holden Lansing, NY	Retired
Stephan M. James Binghamton, NY	Vice-President, Security Mutual Insurance Company
James R. Lichtel East Greenbush, NY	Retired
William H. Maddren Cortland, NY	Retired
Catherine Mawicke Aurora, NY	Investment Broker, Wells Fargo Advisors
Thomas R. Ruane Lansing, NY	President, Security Mutual Insurance Company
Roy E. Staley Ithaca, NY	Retired
Wilfred W. Wege Niskayuna, NY	Retired
Frederick S. Wilder Canton, 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, 2010, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Thomas R. Ruane	President
Delbert L. Hall	Secretary and Treasurer
Stephan M. James	Vice President

B. Territory and Plan of Operation

As of December 31, 2010, the Company was licensed to write business in New York State 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:

<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
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine

Based on 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 \$950,000.

The Company's predominant lines of business are homeowners multiple peril and commercial multiple peril, which accounted for 69.2% and 22.3%, respectively, of the Company's 2010 direct

written business. The Company participates as a direct writer in any combination policy issued by New York Mutual Underwriters (“NYMU”). As of November 1997, the Company shares, with one other advance premium corporation, one-half of all NYMU’s premiums, losses and expenses. NYMU’s predominate lines of business are commercial/special multiple peril, commercial landlord, personal dwellings and allied lines of business. Approximately 10% of the Company’s total direct written premiums were attributable to New York Mutual Underwriters. At December 31, 2010, the Company wrote business through approximately 315 independent agents.

In 2007, the Company began writing boiler and machinery business; however its license did not include authority to write this kind of insurance until it was amended effective February 25, 2010. It is recommended that the Company refrain from writing kinds of insurance for which it is not licensed pursuant to Section 1113(a) of the New York Insurance Law.

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

<u>Calendar Year</u>	<u>Premiums Written</u>
2006	\$36,080,416
2007	\$36,542,097
2008	\$35,907,199
2009	\$36,719,227
2010	\$37,298,725

C. Reinsurance

The Company did not report any assumed reinsurance at December 31, 2010.

Since the last examination, the Company has changed its net retention of \$170,000 and \$120,000 for property and casualty business, respectively, to \$250,000 and \$150,000.

The Company has structured its ceded reinsurance program as follows:

Type of TreatyCessionProperty

1 layer
100% Authorized

\$1,500,000 excess of \$250,000 ultimate net loss each loss, each risk subject to a limit of liability of \$4,500,000 each occurrence.

Property Catastrophe

5 layers

First layer
57.5% Authorized

\$1,500,000 excess of \$1,500,000 ultimate net loss, each loss occurrence. 86% placed.

Second layer
58.5% Authorized

\$1,900,000 (being 95% of \$2,000,000) excess of \$3,000,000 ultimate net loss, each loss occurrence.

Third layer
54.7% Authorized

\$4,750,000 (being 95% of \$5,000,000) excess of \$5,000,000 ultimate net loss, each loss occurrence.

Fourth layer
53.5% Authorized

\$4,750,000 (being 95% of \$5,000,000) excess of \$10,000,000 ultimate net loss, each loss occurrence.

Fifth layer
60.5% Authorized

\$14,250,000 (being 95% of \$15,000,000) excess of \$15,000,000 ultimate net loss, each loss occurrence.

Boiler and Machinery

100% Authorized

100% of \$10,000,000 of equipment breakdown liability.

Casualty

2 layers
100% Authorized

\$2,350,000 excess of \$150,000 ultimate net loss each loss occurrence.

Umbrella

2 layers
First layer
100% Authorized

95% of up to \$1,000,000 ultimate net loss each occurrence, each policy. In addition to these limits, the coverage extends to loss adjustment expense in the ratio the loss payment bears to the total ultimate net loss.

Second layer
100% Authorized

\$4,000,000 excess of \$1,000,000 ultimate net loss each loss occurrence, each policy. In addition to these limits, the coverage extends to loss adjustment expense in the ratio the loss payment bears to the total ultimate net loss.

The Company also has in place up to \$500,000 facultative pro rata coverage for that portion of all property policies that exceed \$1,750,000.

The Company also has aggregate property catastrophe reinsurance coverage in place.

It is the Company's policy to obtain the appropriate collateral for its cessions to unauthorized reinsurers. Letters of credit obtained by the Company to take credit for cessions to unauthorized reinsurers were reviewed for compliance with Department Regulation 133. No exceptions were noted.

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

Examination review found that the Schedule F data reported by the Company in its filed annual statement accurately reflected its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in NAIC Accounting Practices and Procedures Manual, Statements of Statutory Accounting Principles ("SSAP") No. 62. Representations were supported by an attestation from the Company's Chief Executive Officer and Chief Financial Officer pursuant to the NAIC Annual Statement Instructions. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in SSAP No. 62.

During the period covered by this examination, the Company commuted several reinsurance agreements where it is was a ceding reinsurer. These commutations resulted in an increase of \$598,002 to the Company's surplus position as of the commutation date.

D. Affiliated Group

In 1998, the Company organized a subsidiary, to be known as Security Mutual Brokers Services, Inc. ("SMBS") pursuant to Section 1603 of the New York Insurance Law and Part 81-1 of Department Regulation No. 53. SMBS was incorporated to act as a general insurance agency to accept applications for property and casualty insurance of all kinds.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2010, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	.88:1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	59%
Premiums in course of collection to surplus as regards policyholders	5%

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	\$ 90,430,073	58.05%
Other underwriting expenses incurred	63,616,282	40.84
Net underwriting loss	<u>1,741,669</u>	<u>1.11</u>
Premiums earned	<u>\$155,788,024</u>	<u>100.00%</u>

F. Accounts and Records

Reporting of results for New York Mutual Underwriters (“NYMU”)

NYMU is an unincorporated association of two advance premium insurance companies domiciled in New York, one of which is the Company. Direct premiums written by NYMU in 2010 totaled \$7.6 million and consisted predominantly of fire and commercial multiple peril policies. Each of the two companies participates equally in the results of the business written by NYMU.

NYMU collects premiums and remits them to the participating insurers; however, the remittances are generally not made until several months after the premiums are collected by NYMU. The Company explained that the unremitted premiums represent a cash advance by the participating companies to provide funding for the operations of NYMU.

The Company reports the premiums that have been collected by NYMU but have not yet been remitted to the Company as an admitted asset under the caption “Uncollected premiums and agents’ balances in the course of collection.” These unremitted premiums should have been reported under the caption “Equities and deposits in pools and associations” pursuant to paragraph 10 of SSAP 63, which states, in part:

Equity interests in, or deposits receivable from, a pool represent cash advances to provide funding for operations of the pool. These are admitted assets and shall be recorded separately from receivables and payables related to a pool’s underwriting results.

It is recommended that the Company report its share of premiums collected by NYMU, but not yet remitted to the Company as an admitted asset under the caption “Equities and deposits in pools and associations” pursuant to paragraph 10 of SSAP 63.

Additionally, it was noted that NYMU reported to the Company premiums that it had collected prior to the effective date of the policies. The Company did not record these advance premiums anywhere on its financial statements. These advance premiums should have been reported as an admitted asset under the caption “Equities and deposits in pools and associations”, with an offsetting liability under the caption “Advance premiums” pursuant to paragraph 8 of SSAP 63, which states, in part:

Underwriting results relating to voluntary and involuntary pools shall be accounted for on a gross basis whereby the participant’s portion of premiums, losses, expenses and other operations of the pools are recorded separately in the financial statements rather than netted against each other. Premiums and losses shall be recorded as direct, assumed and/or ceded as applicable.

It is recommended that the Company report its share of advance premiums collected by NYMU pursuant to the provisions of paragraph 8 of SSAP 63.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2010, as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$64,899,385	\$ 0	\$64,899,385
Common stocks	7,829,239		7,829,239
Properties occupied by the company	479,351		479,351
Cash, cash equivalents and short-term investments	2,461,275		2,461,275
Investment income due and accrued	701,832		701,832
Uncollected premiums and agents' balances in the course of collection	1,856,786	14,035	1,842,751
Deferred premiums, agents' balances and installments booked but deferred and not yet due	1,857,698		1,857,698
Amounts recoverable from reinsurers	556,772		556,772
Current federal and foreign income tax recoverable and interest thereon	105,561		105,561
Net deferred tax asset	691,097		691,097
Electronic data processing equipment and software	655,747	550,347	105,400
Furniture and equipment, including health care delivery assets	137,311	137,311	0
Company owned life insurance	1,099,107		1,099,107
Equities and deposits in pools and associations	<u>711,802</u>	<u>624</u>	<u>711,802</u>
Total assets	<u>\$84,042,963</u>	<u>\$702,317</u>	<u>\$83,340,646</u>

Liabilities, Surplus and Other FundsLiabilities

Losses and loss adjustment expenses	\$24,294,845
Commissions payable, contingent commissions and other similar charges	929,602
Other expenses (excluding taxes, licenses and fees)	564,923
Taxes, licenses and fees (excluding federal and foreign income taxes)	29,480
Unearned premiums	19,504,176
Advance premium	537,129
Ceded reinsurance premiums payable (net of ceding commissions)	248,135
Amounts withheld or retained by company for account of others	461,134
Provision for reinsurance	302,409
Drafts outstanding	<u>885</u>
Total liabilities	<u>\$46,872,718</u>

Surplus and Other Funds

Aggregate write-ins for special surplus funds	\$ 900,000
Surplus notes	5,000,000
Unassigned funds (surplus)	<u>30,567,928</u>
Surplus as regards policyholders	<u>36,467,928</u>
Total liabilities, surplus and other funds	<u>\$83,340,646</u>

NOTE: The Internal Revenue Service has completed its audits of the Company's Federal Income Tax returns through tax year 2008. All material adjustments, if any, made subsequent to the date of examination and arising from said audits, are reflected in the financial statements included in this report. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2009 and 2010. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Statement of Income

Surplus as regards policyholders increased \$11,223,193 during the five-year examination period January 1, 2006 through December 31, 2010, detailed as follows:

Premiums earned		\$155,788,024
Deductions:		
Losses and loss adjustment expenses incurred	\$90,430,073	
Other underwriting expenses incurred	<u>63,616,282</u>	
Total underwriting deductions		<u>154,046,355</u>
Net underwriting gain or (loss)		\$ 1,741,669
<u>Investment Income</u>		
Net investment income earned	\$11,327,283	
Net realized capital gain	<u>1,037,360</u>	
Net investment gain or (loss)		12,364,643
<u>Other Income</u>		
Finance and service charges not included in premiums	\$ 3,370,441	
Aggregate write-ins for miscellaneous income	<u>(12,194)</u>	
Total other income		<u>3,358,247</u>
Net income before federal and foreign income taxes		\$ 17,464,559
Federal and foreign income taxes incurred		<u>4,730,604</u>
Net income		\$ <u>12,733,955</u>

Surplus as regards policyholders per report on examination as of December 31, 2005			\$25,244,737
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$12,733,955		
Net unrealized capital gains or (losses)		\$1,928,438	
Change in net deferred income tax	597,517		
Change in non-admitted assets	4,471		
Change in provision for reinsurance		184,304	
Aggregate write-ins for gains and losses in surplus	<u>0</u>	<u>8</u>	
Total gains or losses in surplus	<u>\$13,335,943</u>	<u>\$2,112,750</u>	
Net increase (decrease) in surplus			<u>11,223,193</u>
Surplus as regards policyholders per report on examination as of December 31, 2010			<u>\$36,467,930</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$24,294,845 is the same as reported by the Company as of December 31, 2010. 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.

It is noted that the Company was unable to separate its lead paint claims data from its total loss data; therefore, the Department actuaries could not determine the reserve runoff history of the Company's lead paint claims. Additionally, it is noted that the Company's independent actuarial report did not include a reserve for lead paint claims as a separate and distinct line in its actuarial report.

It is recommended that the Company improve its internal data procedures to capture the lead paint claims data separately from its other data. It is further recommended that the Company's independent actuaries include a lead paint claims reserve as a separate item in its actuarial report.

5. MARKET CONDUCT

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 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 the practices of the Company in the following areas:

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

i. Cancellation of Homeowner's Personal Lines Policies

Upon review of a sample of homeowner's personal lines policy cancellations, it was noted that in a number of instances, the Company cited "vacancy of the property" as the sole reason for cancellation.

Section 3425(c)(2)(E) of the New York Insurance Law allows for cancellation of homeowner's personal lines policies after the policy has been effect for sixty days based on:

Physical changes in the property insured occurring after issuance or last anniversary date of the policy which result in the property becoming uninsurable in accordance with the insurer's objective, uniformly applied underwriting standards in effect at the time the policy was issued or last voluntarily renewed. . ."

It is noted that Department Circular Letter 23 (2008) states:

Physical change occurs only when the dwelling or property has been altered or changed in some manner. The fact that an insured is not occupying a residence does not constitute a physical change to the premises within the meaning of Section 3425(c)(2)(E).

It is recommended that the Company refrain from cancelling homeowner's personal lines policies based solely on the property becoming vacant, pursuant to Section 3425(c)(2)(E) of the New York Insurance Law and Department Circular Letter 23 (2008).

ii. Reporting of Fire Losses to the Property Insurance Loss Register (“PILR”)

Pursuant to Section 318(a) of the New York Insurance Law and Parts 62-2.0 and 62-2.2 of Department Regulation 96, insurers must report fire losses in excess of \$1,000 to the PILR within five business days following receipt of notice of loss.

A review of 15 fire losses that exceeded the reporting threshold for PILR notification indicated that for 7 of those losses, notification was either not sent, or was not sent in a timely manner.

It is recommended that the Company report all fire losses in excess of \$1,000 to the PILR within five business days following receipt of notice of loss, pursuant to the provisions of Section 318(a) of the New York Insurance Law and Parts 62-2.0 and 62-2.2 of Department Regulation 96.

No other problem areas were encountered.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Accounts and Records</u>	
i. It is recommended that the Company ensure that its custodial agreements include all of the provisions specified in the NAIC Financial Condition Examiners Handbook and by the New York Insurance Department.	8
The Company has complied with this recommendation.	
ii. It is recommended that the Company comply with Section 6611(a)(1) of the New York Insurance Law and maintain proper records and books of accounts at NYMU which will allow for the verification of the amounts reported in its annual statements relative to its membership in NYMU.	9
The Company has complied with this recommendation.	

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A. <u>Territory and Plan of Operation</u></p> <p>It is recommended that the Company refrain from writing kinds of insurance for which it is not licensed pursuant to Section 1113(a) of the New York Insurance Law.</p>	<p>6</p>
<p>B. <u>Accounts and Records</u></p> <p>i. It is recommended that the Company report its share of premiums collected by NYMU, but not yet remitted to the Company as an admitted asset under the caption “Equities and deposits in pools and associations” pursuant to paragraph 10 of SSAP 63.</p> <p>ii. It is recommended that the Company report its share of advance premiums collected by NYMU pursuant to the provisions of paragraph 8 of SSAP 63.</p>	<p>10</p> <p>10</p>
<p>C. <u>Losses and Loss Adjustment Expenses</u></p> <p>i. It is recommended that the Company improve its internal data procedures to capture the lead paint claims data separately from its other data.</p> <p>ii. It is recommended that the Company’s independent actuaries include a lead paint claims reserve as a separate item in its actuarial report.</p>	<p>14</p> <p>14</p>
<p>D. <u>Market Conduct</u></p> <p>i. It is recommended that the Company refrain from cancelling homeowner’s personal lines policies based solely on the property becoming vacant, pursuant to Section 3425(c)(2)(E) of the New York Insurance Law and Department Circular Letter 23 (2008).</p> <p>ii. It is recommended that the Company report all fire losses in excess of \$1,000 to the PILR within five business days following receipt of notice of loss, pursuant to the provisions of Section 318(a) of the New York Insurance Law and Parts 62-2.0 and 62-2.2 of Department Regulation 96.</p>	<p>15</p> <p>16</p>

Respectfully submitted,

_____/s/
Frank P. Schiraldi
Senior Insurance Examiner

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

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

_____/s/
Frank P. Schiraldi

Subscribed and sworn to before me
this _____ day of _____, 2012.

Appointment No. 30702

*STATE OF NEW YORK
INSURANCE DEPARTMENT*

*I, James J. Wrynn Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:*

Frank Schiraldi

as proper person to examine into the affairs of the

SECURITY MUTUAL 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 6th day of April, 2011



James J. Wrynn

JAMES J. WRynn
Superintendent of Insurance