

REPORT ON EXAMINATION

OF THE

EMPIRE INSURANCE COMPANY

AS OF

DECEMBER 31, 2003

DATE OF REPORT

OCTOBER 10, 2007

EXAMINER

BERNARD LOTT

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

October 10, 2007

Honorable Eric R. Dinallo
Superintendent of Insurance
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 22146 dated February 3, 2004 attached hereto, I have made an examination into the condition and affairs of Empire Insurance Company as of December 31, 2003, and submit the following report thereon.

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

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

The examination was conducted at the Company’s home office located at 45 Main Street, Brooklyn, New York 11201.

1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1999. This examination covered the four-year period from January 1, 2000 through December 31, 2003. Where deemed appropriate, transactions occurring subsequent to the examination period were reviewed.

The examination comprised a complete verification of assets and liabilities as of December 31, 2003. 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 incorporated under the laws of the State of New York as the Red Cap Mutual Casualty Company on February 6, 1925. It began business March 1, 1925. The name was changed to Empire Mutual Casualty Company in 1937 and to Empire Mutual Insurance Company in 1953. Under a plan of demutualization adopted on December 20, 1985, the stock company was formed on January 1, 1988 under its present name.

Effective December 31, 2001, the Company merged with its wholly-owned subsidiary, Centurion Insurance Company and on December 31, 2003 the Company merged with substantially-owned (84.6%) subsidiary, Allcity Insurance Company (“Allcity”), with Empire as the surviving company.

The Company’s common capital stock of \$11,309,200, comprised of 113,092 outstanding common shares with a par value of \$100 per share, remained constant throughout the period covered by this examination. Authorized common shares remained unchanged at 120,000.

At December 31, 2003, the Company’s gross paid-in and contributed surplus of \$52,143,276 includes a \$2,924,699 increase during the period covered by this examination as follows:

<u>Year</u>	<u>Description</u>		<u>Amount</u>
1999	Beginning gross paid in and contributed surplus		\$49,218,577
2002	Surplus contribution	\$157,923	
2003	Surplus contribution	<u>2,766,776</u>	
	Total surplus contributions		<u>2,924,699</u>
2003	Ending gross paid in and contributed surplus		<u>\$52,143,276</u>

The 2003 surplus contribution of \$2,766,776 represents the contribution by the Company’s ultimate parent, Leucadia National Corporation (“Leucadia”), of 1,091,224 shares of Allcity Insurance Company (“Allcity”) at its statutory book value as of December 31, 2002.

At December 31, 2002, the Company owned approximately 84.6% of the 7,078,625 issued and outstanding shares of Allcity. Of the remaining 1,091,224 outstanding shares, 471,407 were owned by Leucadia and 619,817 were owned by various minority shareholders. In 2003, Leucadia acquired the shares owned by the minority shareholders according to a “Plan for acquisition of minority interests in a subsidiary insurer” pursuant to Section 7118 of the New York Insurance Law

(“the Plan”). Pursuant to the Plan, Leucadia offered to purchase the shares of Allcity held by the minority shareholders at a price of \$2.75/share, which exceeded the statutory value of \$2.53/share. Upon completion of the acquisition of minority shares, Leucadia contributed the 1,091,224 shares of Allcity to the Company.

After the contribution of Allcity’s shares by Leucadia, the Company owned 100% of the outstanding shares of Allcity, at which point, Allcity was merged with and into Empire, with Empire as the surviving entity.

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 thirteen nor more than twenty-one members. The Company’s by-laws state that the board shall hold at least four quarterly meetings each calendar year. As of December 31, 2003, there were thirteen directors of the Company, as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Martin Benjamin Bernstein North Salem, NY	Chairman, Bedford Capital
Ian MacNeill Cumming Jackson, WY	Chairman, Leucadia National Corporation
Christopher James Gruttemeyer Nanuet, NY	Vice President, Empire Insurance Company
James Edward Jordan New York, NY	Director, Leucadia National Corporation
Thomas Edward Mara Franklin Lakes, NY	Executive Vice President and Treasurer, Leucadia National Corporation
Rocco Joseph Nittoli Old Bridge, NJ	Vice President and Chief Operating Officer, Empire Insurance Company
Joseph Anthony Orlando Harrison, NY	Vice President and Chief Financial Officer, Leucadia National Corporation
Herbert Eugene Scruggs Salt Lake City, UT	President and Chief Executive Officer, Empire Insurance Company
Louis Vincent Siracusano East Meadow, NY	Attorney, McKenna, Siracusano, Fehringer & Chianese

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Joseph Saul Steinberg Brooklyn, NY	President, Leucadia National Corporation
Daniel Glenn Stewart Short Hills, NJ	Independent consulting actuary
Lucius Theus Bloomfield Hills, MI	President, The U.S. Associates
Harry Haven Wise New York, NY	President, H. W. Associates, Inc.

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 had an acceptable record of attendance.

As of December 31, 2003, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Herbert E. Scruggs	President and Chief Executive Officer
Rocco J. Nittoli	Vice President & Chief Operating Officer
Christopher J. Gruttemeyer	Vice President, Business Analysis
Douglas Whitenack	Vice President & Chief Financial Officer
Edward A Hayes	Senior Vice President, Claims
Adam C Cheven	Vice President, Underwriting
C. Gary Brown	Vice President, Information Services
Lisa M. Bencivenga	Assistant Vice President & Secretary

Conflict of Interest Statements

A review of signed conflict of interest affidavits noted that the Company obtained signed affidavits from all directors, officers and employees for the year 2000. Thereafter, only new employees signed conflict of interest affidavits.

It is recommended that the Company require all directors and officers to sign conflict of interest affidavits on an annual basis.

B. Territory and Plan of Operation

In March of 2001, the Company submitted to the Department a plan to cease writing new business and withdraw from all lines of business being written in New York State, pursuant to the provisions of Sections 3425(o) and 3426(e)(8) of the New York Insurance Law. The plan noted that personal automobile policies will only be non-renewed pursuant to the limitations of Section 3425(f) of the New York Insurance Law, resulting in the overwhelming majority of personal automobile business being retained. The Department acknowledged the withdrawal plans and placed them on file.

In May 2001, the Company requested that the superintendent allow it to non-renew all of its private passenger automobile business; in July 2001, the superintendent denied this request. In April 2002, the Company advised the Department that it had sent out letters advising its producers and general agents that all private passenger automobile renewal policies written five months or more after April 2002 would have a 0% commission.

On December 27, 2006, the superintendent determined that pursuant to Section 3425(c) of the New York Insurance Law, the continuation of Empire's present premium volume would be hazardous to the interests of its policyholders. Accordingly, the Company was advised that it may non-renew its entire private passenger automobile book of business by providing 60 days' notice prior to the effective date of the renewal of each policy.

The Company maintains its license in New York, along with the following states: Connecticut, Massachusetts, Missouri, New Hampshire and New Jersey. It should be noted that the Company's Missouri certificate of authority was suspended April 15, 2002. Additionally, Empire was ordered not to write any new or renewal business in the State of New Hampshire, effective September 12, 2002. It appears both restrictions were due to its voluntary run-off of business.

As of the examination date, the Company was authorized to transact the kinds of insurance as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

<u>Paragraph</u>	<u>Line of Business</u>
3	Accident & health
4	Fire
5	Miscellaneous property damage
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
10	Elevator
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
16	Fidelity and surety
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 the Company's current capital structure, and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$3,400,000.

C. Reinsurance

The Company did not have any reinsurance coverage during 2003. For policies issued prior to January 1, 2002, the Company is reinsured in excess of \$300,000 to an ultimate limit of \$30,000,000. Due to the Company's run-off status, reinsurance coverage was non-renewed effective January 1, 2002, except for its worker's compensation coverage in excess of \$10,000,000 up to \$30,000,000 that was non-renewed effective July 1, 2002.

D. Holding Company System

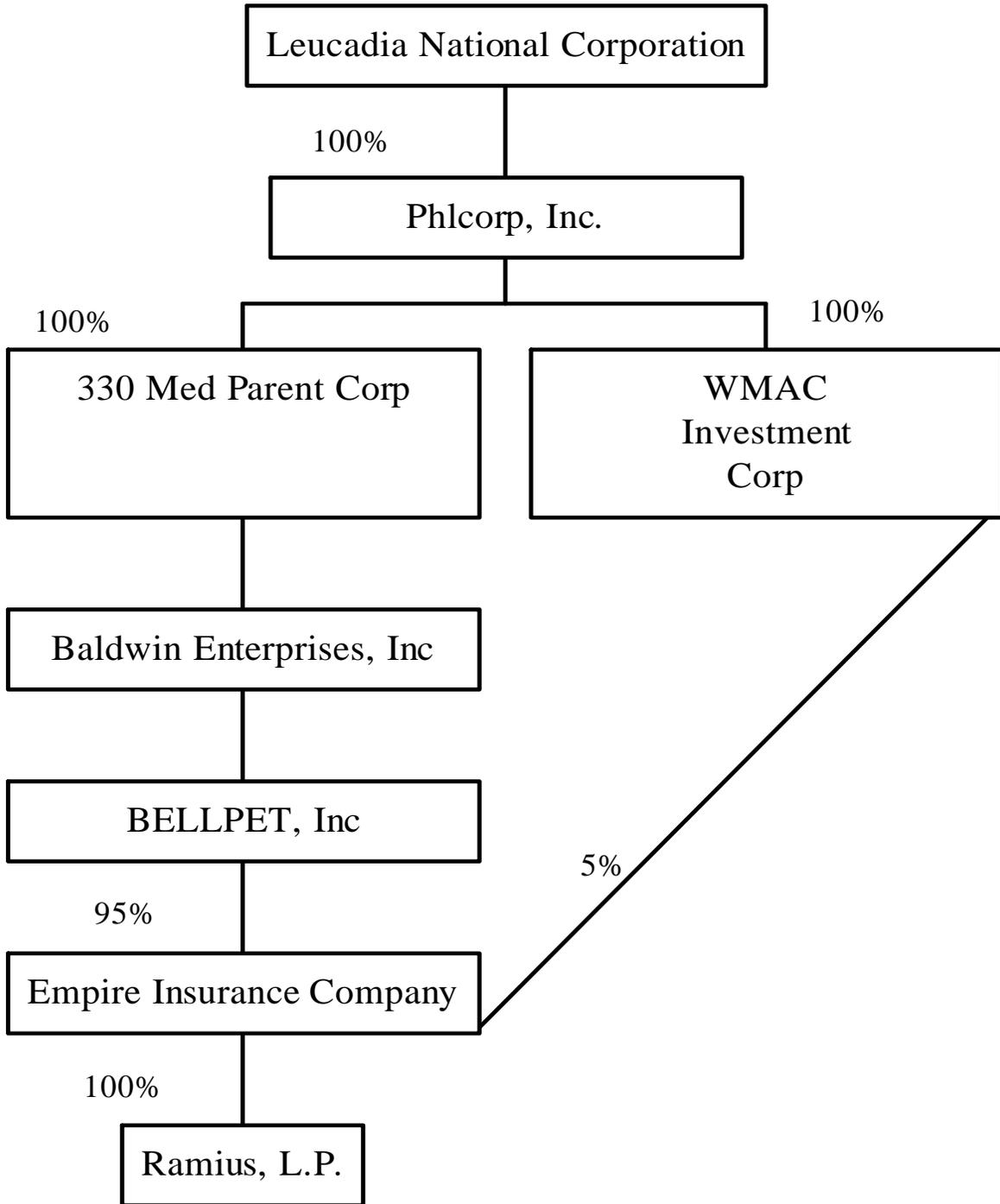
Empire Insurance Company is 100% owned and controlled, through various subsidiaries, by Phlcorp Inc., a holding company primarily engaged in the business of insurance and incentive services. Phlcorp Inc. is a 100% owned subsidiary of Leucadia National Corporation, the Company's ultimate parent. Leucadia National Corporation, whose common stock shares are traded on the New York Stock Exchange, is a holding company for its consolidated subsidiaries engaged in a variety of

businesses including telecommunications, manufacturing, banking and lending, real estate and property and casualty insurance.

As a member of a holding company system, the Company is required to file an annual holding company registration statement (Form HC-1), pursuant to Article 15 of the New York Insurance Law and Part 80-1.4 of Department Regulation 52. A review of the Company's filings with this Department, for the period covered by this examination, indicated that no filings were made for the years 2000 and 2001.

It is recommended that the Company file its annual holding company registration statements in a timely manner pursuant to the provisions of Part 80-1.4 of Department Regulation 52.

The following is an abridged chart of the holding company system at December 31, 2003: reflecting only the Company's direct parents and subsidiaries:



Empire maintains the following inter-company agreements with its parents and affiliates:

Tax Allocation Agreement

The Company maintains a tax allocation agreement with Leucadia National Corporation, whereby a consolidated federal income tax return is filed on its behalf. The agreement was reviewed and found not to be in full compliance with Circular Letter No. 33 (1979). The Circular Letter provides, in pertinent part, that:

“...Every domestic insurer which is a party to a consolidated federal income tax filing must have a definitive written agreement, approved by its Board of Directors, governing its participation therein.

2. The ultimate holding corporation, any intermediate corporation which owns a controlling interest in the stock of the domestic insurer and the domestic insurer itself must be parties to, but need not necessarily participate in, the consolidated federal income tax agreement.”

A review of Empire’s board of directors’ minutes noted that the tax allocation agreement had not been approved by the board. In addition, a review of the agreement found that the immediate parent, BellPet, Inc., which controls 95% of the Company, was not a party to the agreement.

It is recommended the Company's board of directors ratify its tax allocation agreement. It is also recommended that the tax allocation agreement be amended to include the Company’s immediate parent, BellPet, Inc., as a party to the agreement, pursuant to Circular Letter No. 33 (1979).

Management Agreement

Effective December 31, 2003, due to the merger of the Company with Centurion Insurance Company and Allcity Insurance Company, the management agreement shared with affiliates was terminated.

Agency Agreements with Affiliates

In addition, the Company maintained agency agreements with affiliates Adam Street Insurance Agency and Empire Livery Service Inc., during the period covered by this examination. Effective December 31, 2003, these agreements were cancelled upon dissolution of the respective affiliates.

Partnerships Investment

On December 21, 2004, based upon the recommendation of the Ramius Advisors, L.L.C., the general partner and investment advisor to Ramius, L.P., the Company liquidated its investment in Ramius, L.P. The Company realized \$23,069,000 on the cancellation of the partnership.

E. Abandoned Property Law

Section 1316 of the New York State Abandoned Property Law provides that amounts payable to a resident of this state from a policy of insurance, if unclaimed for three years, shall be deemed to be abandoned property. Such abandoned property shall be reported to the New York State Comptroller on or before the first day of April each year. Such filing is required of all insurers regardless of whether or not they have any abandoned property to report.

Concurrent with this examination, the New York State Department of Audit and Control was conducting an examination of the Company's Abandoned Property filings.

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 2003, based upon the results of this examination:

Net premiums written in 2003 to surplus as regards policyholders	.87:1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	117.0%
Premiums in course of collection to surplus as regards policyholders	.90%

The second ratio above (Liabilities to liquid assets) falls outside the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners. It appears the unusual value is caused by a decrease in the liquid assets of the Company.

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

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$306,737,035	162.38%
Other underwriting expenses incurred	98,447,742	52.12
Net underwriting loss	<u>(216,284,224)</u>	<u>(114.50)</u>
Premiums earned	<u>\$188,900,553</u>	<u>100.00%</u>

G. Accounts and Records

Custodian Agreement

The Company answered affirmatively to the following General Interrogatory in its filed annual statement as of December 31, 2003:

“Excluding items in Schedule E, real estate, mortgage loans and investments held physically in the reporting entity’s offices, vaults or safety deposit boxes, were all stocks, bonds and other securities, owned throughout the current year held pursuant to a custodial agreement with a qualified bank or trust company in accordance with Part 1 – General, Section IV.H- Custodial or Safekeeping Agreements of the NAIC Financial Condition Examiners Handbook?”

A review performed during the examination, however, found the Company’s custodial agreement to be lacking in the guidance, set forth in the NAIC’s Examiners Handbook, for the evaluation of custodial or safekeeping agreements. Safeguards missing from the Company’s agreement included but were not limited to the following:

1. “That the national bank, state bank, or trust company, as custodian is obligated to indemnify the insurance company for any insurance company’s loss of securities in the custodian’s custody...”
2. “That in the event of a loss of the securities for which the custodian is obligated to indemnify the insurance company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced...”
3. “That the national bank, state bank or trust company as custodian shall not be liable for any failure to take any action required to be taken hereunder in the event and to the extent that the taking of such action is prevented or delayed by war (whether declared or not and including existing wars), revolution, insurrection, riot, civil commotion, act of God, accident, fire, explosions, stoppage of labor, strikes or other differences with employees, laws, regulations, orders or other acts of any governmental authority, or any other cause whatever beyond its reasonable control...”

It is recommended that the Company amend its custodial agreement to include all of the protective covenants set forth in the guidelines to the NAIC's Examiners Handbook. It is also recommended that the Company take due care to correctly complete the General Interrogatories in its filed annual statement.

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, 2003 and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	Assets Not <u>Admitted</u>	Net Admitted <u>Assets</u>
Bonds	\$ 94,925,796	\$ 0	\$ 94,925,796
Preferred stocks (stocks)	450	0	450
Cash and short-term investments	42,266,993	0	42,266,993
Other invested assets	25,797,508	0	25,797,508
Investment income due and accrued	940,430	0	940,430
Uncollected premiums and agents' balances in course of collection	296,256	166,391	129,865
Amounts recoverable from reinsurers	5,647,130	0	5,647,130
Net deferred tax assets	96,222,253	96,222,253	0
Furniture and equipment	639,774	639,774	0
Employee retention trust account	3,755,672	0	3,755,672
Equities and deposits in pools and associations	1,192,162	0	1,192,162
Prepaid assets	133,798	133,798	0
Receivable from sub-tenants	400,854	0	400,854
Service fee receivable - net	32,785	0	32,785
Outside claim adjuster imprest account	50,400	0	50,400
Advances to outside claim adjusters	155,262	148,462	6,800
Deposit with landlord and interest receivable	712,788	495,704	217,084
Surplus drafts receivable	185,889	185,889	0
Security deposits	250,000	250,000	0
Sub-lease inducement assets	<u>11,439,794</u>	<u>11,439,794</u>	<u>0</u>
Total Assets	<u>\$285,045,994</u>	<u>\$109,682,065</u>	<u>\$175,363,929</u>

NOTE 1: Differences found in these and other schedules are due to rounding.

Liabilities, Surplus and Other Funds

<u>Liabilities</u>	<u>Examination</u>	<u>Company</u>	<u>Surplus Increase (Decrease)</u>
Losses	\$116,074,219	\$116,074,219	
Loss adjustment expenses	27,375,000	27,375,000	
Other expenses (excluding taxes, licenses and fees)	2,553,941	2,553,941	
Taxes, licenses and fees (excluding federal and foreign income taxes)	1,849,495	(675,505)	(2,525,000)
Unearned premiums	1,390,798	1,390,798	
Advance premiums	93,008	93,008	
Ceded reinsurance premiums payable (net of ceding commissions)	721,778	721,778	
Amounts withheld or retained by company for account of others	4,419	4,419	
Provision for reinsurance	1,001,600	1,001,600	
Drafts outstanding	1,522,551	1,522,551	
Payable to parent, subsidiaries and affiliates	4,536,770	4,536,770	
Other post-retirement benefits	3,482,623	3,482,623	
Provision for servicing carrier claim expenses	2,186,063	2,186,063	
Unclaimed checks	<u>662,659</u>	<u>662,659</u>	<u>0</u>
Total liabilities	<u>\$163,454,924</u>	<u>\$160,929,924</u>	<u>\$(2,525,000)</u>
<u>Surplus and Other Funds</u>			
Common capital stock	\$ 11,309,200	\$ 11,309,200	
Gross paid in and contributed surplus	52,143,276	52,143,276	
Unassigned funds (surplus)	<u>(51,543,471)</u>	<u>(49,018,471)</u>	<u>(2,525,000)</u>
Surplus as regards policyholders	<u>\$ 11,909,005</u>	<u>\$ 14,434,005</u>	<u>\$(2,525,000)</u>
Total liabilities, surplus and other funds	<u>\$175,363,929</u>	<u>\$175,363,929</u>	

NOTE 2: The Internal Revenue Service (“IRS”) has completed its audits of the consolidated tax returns filed on behalf of the Company through tax year 1999. The Company is not currently being audited by the IRS for any tax year covered by this examination. With the exception of any impact that might be caused from any examination changes contained in this report, the examiner is unaware of any potential exposure of the Company to any further tax assessments and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders decreased \$ 125,123,509 during the period January 1, 2000 through December 31, 2003 detailed as follows:

Underwriting Income

Premiums earned		\$ 188,900,553
Deductions:		
Losses incurred	\$200,917,402	
Loss adjustment expenses incurred	105,819,633	
Other underwriting expenses incurred	94,850,947	
Aggregate write-ins for underwriting deductions	<u>3,596,795</u>	
Total underwriting deductions		<u>402,659,777</u>
Net underwriting gain or (loss)		\$ (216,284,224)

Investment Income

Net investment income earned	\$ 74,167,510	
Net realized capital gains	<u>(8,676,880)</u>	
Net investment gain or (loss)		65,490,630

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (11,379,571)	
Finance and service charges not included in premiums	1,508,648	
Aggregate write-ins for miscellaneous income	<u>14,108,267</u>	
Total other income		<u>4,237,344</u>
Net income before dividends to policyholders and before federal and foreign income taxes		\$ (146,556,250)
Dividends to policyholders		<u>120,727</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$ (146,676,977)
Federal and foreign income taxes incurred		<u>(489,567)</u>
Net Income		<u>\$ (146,187,410)</u>

C. Capital and Surplus Account

Surplus as regards policyholders per report on examination as of December 31, 1999			\$139,557,514
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income		\$ 146,187,410	
Net unrealized capital gains or (losses)	\$ 10,267,618		
Change in net deferred income taxes	96,222,253		
Change in non-admitted assets		80,992,637	
Change in provision for reinsurance		633,600	
Cumulative effect of changes in accounting principles		950,700	
Surplus adjustments paid in	157,923		
Dividends to stockholders		365,561	
Recognition of minimum defined benefit pension liability	_____	<u>5,166,395</u>	
Total gains and losses	<u>\$106,647,794</u>	<u>\$ 234,296,303</u>	
Net decrease in surplus as regards policyholders			125,123,509
Surplus as regards policyholders per report on examination as of December 31, 2003			\$ <u>11,909,005</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$143,449,219 is the same amount as reported by the Company as of December 31, 2003. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Company's internal records and in its filed annual statements.

5. TAXES, LICENSES AND FEES

The examination liability for the captioned item of \$1,849,495 is \$2,525,000 more than the \$(675,505) reported by the Company as of December 31, 2003. In the notes to the financial statement, the Company disclosed a dispute with the New York State Department of Taxation and Finance ("DTF") concerning franchise tax returns for the years 1992 through 1996. DTF contends that the Company should have filed combined returns with its affiliate Allcity for the years in question. The Company disputed this but noted that if required to amend its returns it would incur a liability of approximately \$5.7 million. As of the examination date, the Company did not accrue an amount for this contingency.

Subsequent to the examination date the Company resolved this matter with a tentative compromise settlement where it will pay \$1,375,000 in franchise taxes and related surcharge tax plus interest of approximately \$1,150,000. This amount has been accrued for in Empire's December 31, 2004 annual statement.

6. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business practices and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the more precise scope of a market conduct investigation, which is the responsibility of the Market Conduct Unit of the Property Bureau of this Department.

The general review was directed at practices of the Company in claims and complaint handling. A review of the Company's complaint log noted that sixty-four percent of all complaints failed to comply with Department Regulation 64, Part 216.4 (d). Regulation 64, Part 216.4 (d) states:

“[e]very insurer, upon receipt of any inquiry from the Insurance Department respecting a claim, shall, within 10 business days, furnish the department with the available information requested respecting the claim.”

It is recommended that the Company respond to Department complaint letters within ten days, pursuant to Part 216.4 (d) of Department Regulation 64.

In a separate sample of no-fault claims it was noted that sixty percent of these claims contained late payments, pursuant to Part 65-3.8 of Department Regulation 68-C. Additionally, forty percent failed to pay interest on late payments, pursuant to Part 65-3.9 of Department Regulation 68-C.

It is recommended that the Company make timely no-fault claims payments pursuant to the definition of overdue in Part 65-3.8 of Department Regulation 68-C. It is also recommended that the Company pay interest on all overdue no-fault claims, as provided for in Part 65-3.9 of Department Regulation 68-C.

7. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

A review was made into the actions taken by the Company with regards to the comments and recommendations contained in the prior report on examination. The sixteen comments and recommendations and the Company responses are as follows (page numbers refer to the prior report):

<u>ITEM</u>	<u>PAGE NO.</u>
A	
<u>Impairment of Capital Stock</u>	
The examination has determined that as of December 31, 1999, the Company's capital stock of \$11,309,200 was impaired in the amount of \$7,404,843. The impairment was the result of the examination increase of \$78,450,000 to the Company's reported liabilities for losses and loss adjustment expenses, as well as a reduction to the carrying value of the Company's investment in its subsidiary insurer.	1
On August 27, 2001, the Company submitted a "Plan to Remedy Empire Insurance Company's Examination Impairment". This plan included various steps to improve its surplus position as indicated by the report on examination dated June 27, 2001.	
B.	
<u>Reinsurance</u>	
It is recommended that the Company endeavor to obtain signed interest and liability agreements for all of its reinsurance agreements, in accordance with the NAIC Accounting Practices and Procedures Manual.	7
This recommendation is no longer applicable.	
C.	
<u>Holding Company System</u>	
i.	
It is again recommended that the Company either settle its tax liability in accordance with the terms of the tax allocation agreement or amend the agreement to reflect the current method. Any change to the agreement would have to be filed with the Department for approval.	12
The Company has complied with this recommendation.	
ii.	
It is recommended that the management agreement be amended to reflect the Company's current name and that the amendment be submitted to the Department pursuant to Section 1505 (d)(3) of the New York Insurance Law.	13
Due to the Company's merger with Allcity and Centurion during the period covered by this examination, the management agreement is no longer in-force as of December 31, 2003.	

<u>ITEM</u>	<u>PAGE NO.</u>
iii. It is also recommended that the agency agreements with Gould Dente Agency, Inc. and Oscar Katz Agency, Inc, be submitted to the Department pursuant to the Section 1505(d)(3) of the New York Insurance Law.	14
The Company complied with this recommendation. Effective December 31, 2003, these agreements were cancelled upon dissolution of the respective affiliates.	14
iv. It is recommended that the Company include Ramius LP in its organizational chart, Schedule Y- Part 2 of the annual statement, as a subsidiary that is 70% owned by Empire and 30% owned by Allcity.	14
The Company has complied with this recommendation.	
v. It also recommended the transactions between Empire and Ramius L.P. be disclosed in Schedule Y – Part 1 of the annual statement, pursuant to the guidelines in the NAIC’s Annual Statement Instructions Property & Casualty.	14
The Company has complied with this recommendation.	
vi. It is recommended that the Company not invest in subsidiaries in amounts that exceed the limitation imposed by Section 1611 of the New York Insurance Law.	14
The Company has complied with this recommendation.	
D. <u>Audited Financial Statements</u> It is recommended that the Company have the provisions of Section 89.2 of the Department’s Regulation 118 incorporated into its audit engagement letter with its certified public accountant.	17
The Company has complied with this recommendation.	
E. <u>Custodian Service Agreement</u> It is recommended that the Company amend its custodian agreement with Fleet Bank to include the necessary safeguards and controls required by the Department.	17
The Company has not complied with this recommendation. A similar recommendation is contained in this report.	
F. <u>Accounts and Records</u> i. It is also recommended that the Company exercise proper care to accurately respond to Schedule P Interrogatories in its annual statement.	18
The Company has complied with this recommendation.	

<u>ITEM</u>	<u>PAGE NO.</u>
ii. It is also recommended the Company implement the use of the definitions for losses and loss adjustment expenses in all future statements filed with the New York State's Superintendent of Insurance. The Company has complied with this recommendation.	18
G. <u>Abandoned Property Law</u> It is recommended that the Company file annual abandoned property reports, pursuant to Sections 1315 and 1316 if the New York State Abandoned Property Law, with the State of New York and subsequently escheat any unclaimed property indicated in the report. The Company has complied with this recommendation in regards to the filing of abandoned property reports with the State of New York. Concurrent with this examination, the New York State Department of Audit and Control was conducting a full-scale examination of the Company's abandoned property filings. No examination review was performed to test that the Company was properly escheating unclaimed property to New York State.	19
H. <u>Lack of Cooperation</u> It is recommended that the Company facilitate future examinations in a timely manner. The Company has complied with this recommendation and has assisted in the facilitation of the current examination.	19
I. <u>Common Stocks</u> The common stock asset was reduced, pursuant to the examination, by the amount of \$47,577,686. The reduction was due to a decrease in the market value of a subsidiary, Allcity Insurance Company, and a decrease in an investment in excess of a limitation imposed by Section 1408 of the New York Insurance Law. Effective December 31, 2001, the Company merged with its wholly-owned subsidiary, Centurion Insurance Company and on December 31, 2003 the Company merged with substantially-owned (84.6%) affiliate, Allcity Insurance Company ("Allcity"), with Empire as the surviving company.	23
J. <u>Losses and Loss Adjustment Expenses</u> As a result of the actuarial analysis conducted as part of this examination, the Company's losses and loss adjustment expense reserves as reported in its 1999 filed annual statements were found to be deficient by \$78,450,000. It is recommended that the Company report adequate reserves for losses and loss adjustment expenses in accordance with Section 1303 of the New York Insurance Law. The Company has complied with this recommendation. The examination has not noted a deficiency.	24

8. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u> It is recommended that the Company require all directors and officers to sign conflict of interest affidavits on an annual basis.	5
B. <u>Holding Company System</u>	
i. It is recommended that the Company file its annual holding company registration statements in a timely manner pursuant to the provisions of Part 80-1.4 of Department Regulation 52.	8
ii. It is recommended the Company's board of directors ratify its tax allocation agreement.	10
iii. It is also recommended that the Company amend to tax allocation agreement to include its immediate parent, BellPet, Inc., as a party to the agreement, pursuant to Circular Letter No. 33 (1979).	10
C. <u>Accounts and Records</u>	
i. It is recommended that the Company amend its custodial agreement to include all of the protective covenants set forth in the guidelines to the NAIC's Examiners Handbook.	13
ii. It is also recommended that the Company take due care to correctly complete the General Interrogatories in its filed annual statement.	13
D. <u>Taxes, licenses and fees</u> Subsequent to the examination date the Company resolved a dispute with the New York State Department of Taxation and Finance with a tentative compromise settlement where it will pay \$1,375,000 in franchise taxes and related surcharge tax plus interest of approximately \$1,150,000.	18
E. <u>Market Conduct Activities</u>	
i. It is recommended that the Company respond to Department complaint letters within ten days, pursuant to Part 216.4 (d) of Department Regulation 64.	19
ii. It is recommended that the Company make timely no-fault claims payments pursuant to the definition of overdue in Part 65-3.8 of Department Regulation 68-C.	19
iii. It is also recommended that the Company pay interest on all overdue no-fault claims, as provided for in Part 65-3.9 of Department Regulation 68-C.	19

Respectfully submitted,

_____/S/_____

Bernard Lott
Senior Insurance Examiner

STATE OF NEW YORK)
)SS.
)
COUNTY OF NEW YORK)

BERNARD LOTT, being duly sworn, deposes and says that the foregoing report submitted to by him is true to the best of his knowledge and belief.

_____/S/_____

Bernard Lott

Subscribed and sworn to before me

this _____ day of _____ 2007.

Appointment No 22146

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:

Bernard Lott
Bernard Lott

as proper person to examine into the affairs of the

EMPIRE INSURANCE COMPANY

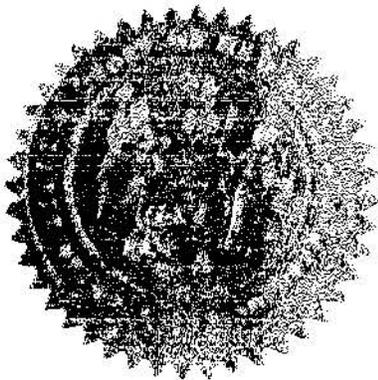
and to make a report to me in writing of the condition of the said

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 3rd day of February, 2004



[Signature]

GREGORY V. SERIO
Superintendent of Insurance