

REPORT ON EXAMINATION

OF THE

EMPIRE INSURANCE COMPANY

AS OF

DECEMBER 31, 2006

DATE OF REPORT

FEBRUARY 20, 2008

EXAMINER

JAINARINE TILAKDHARRY

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

February 20, 2008

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 22678 dated September 13, 2007 attached hereto, I have made an examination into the condition and affairs of Empire Insurance Company as of December 31, 2006, 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 315 Park Avenue South, New York, New York 10010.

1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 2003. This examination covered the three-year period from January 1, 2004 through December 31, 2006. 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, 2006. The examination included a review of income, disbursements and company records deemed necessary to accomplish such analysis or verification and utilized, to the extent considered appropriate, work performed by the Company's independent 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 ("NAIC"):

- 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 Cab 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 another wholly-owned subsidiary, Allcity Insurance Company (“Allcity”), with Empire as the surviving company in both instances.

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. At December 31, 2006 the amount of authorized common stock remained unchanged at 120,000 shares.

At December 31, 2006, the Company’s gross paid-in and contributed surplus was \$52,143,276. There was no change since the prior examination.

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 stated that the board shall hold at least four quarterly meetings each calendar year. On February 7, 2005, the board of directors passed a resolution to amend the Company’s by-laws, requiring the board of directors to meet at least once each calendar year. However, this amendment was not submitted to the Department until December 12, 2007.

In 2005, the Company relocated its home office from Brooklyn (Kings County), New York to New York, New York.

As of December 31, 2006, 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 Cornwall, 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	President and Chief Executive Officer, Empire Insurance Company
Joseph Manning O'Connor Jersey City, NJ	Vice President, Leucadia National Corporation
Joseph Anthony Orlando Harrison, NY	Vice President and Chief Financial Officer, Leucadia National Corporation
Herbert Eugene Scruggs Salt Lake City, UT	Vice President, Leucadia National Corporation
Louis Vincent Siracusano East Meadow, NY	Attorney, McKenna, Siracusano, Fehringer & Chianese
Joseph Saul Steinberg Brooklyn, NY	President, Leucadia National Corporation
Lucius Theus Bloomfield Hills, MI	President, The Wellness Group, Inc.
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, 2006, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Rocco J. Nittoli	President and Chief Executive Officer
Douglas M. Whitenack	Senior Vice President, CFO & Treasurer
Christopher J. Gruttemeyer	Vice President, Business Analysis
Lisa M. Muscarella	Vice President, Complex Claims & Secretary
Edward A. Hayes	Senior Vice President, Claims
Adam C. Cheven	Vice President, Underwriting
Charles G. Brown	Vice President, Information Services
Tara N. Barlin	Vice President, Outsourced Claims

Effective July 1, 2007, Mr. Rocco J. Nittoli resigned from the Company and was replaced by Mr. Douglas M. Whitenack as president and chief executive officer. Also, effective July 1, 2007, Mr. Christopher J. Gruttemeyer became the senior vice president, chief financial officer and treasurer. Mr. Charles G. Brown was released from the Company, effective August 24, 2007.

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 2004. Thereafter, only the new director and the employees who were promoted 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 a plan to the Department of its intention 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 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 in 2006. Generally, 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.

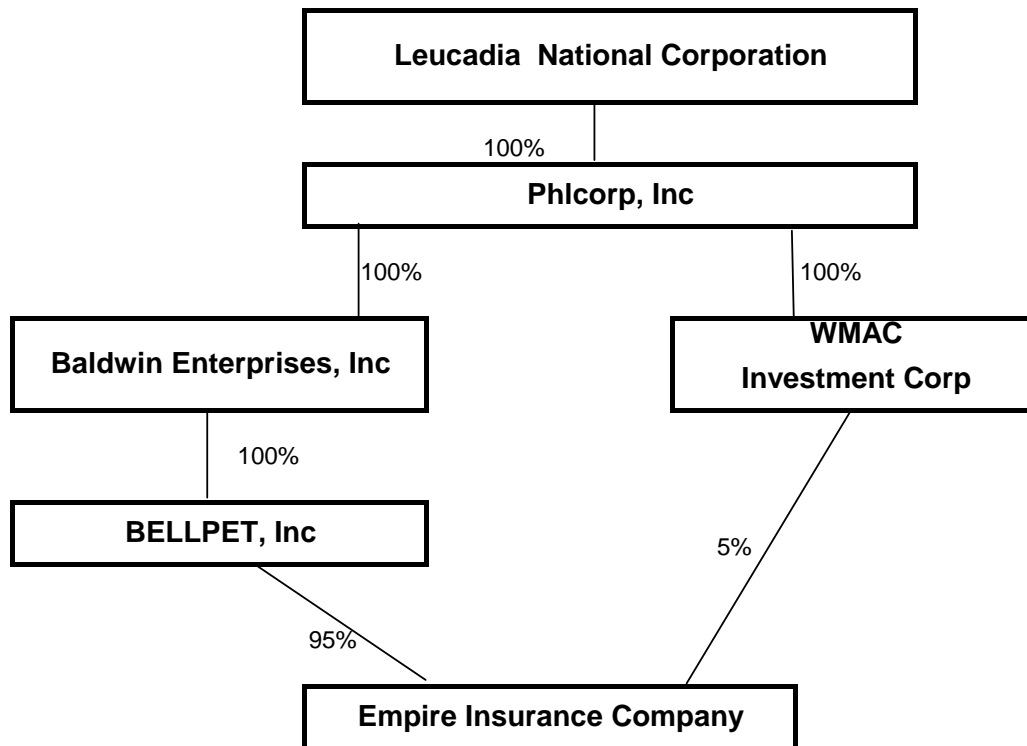
D. Holding Company System

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, real estate activities, medical

product development, winery operations and residual banking and lending activities that are in run-off.

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 holding company registration statements filed with this Department indicated that such filings were complete and were filed in a timely manner.

The following is an abridged chart of the holding company system at December 31, 2006: reflecting only the Company's direct parents and subsidiaries:



As of the examination date, the Company was a party to the following agreements with other members of its holding company system:

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), which states, 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 that 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).

Service Agreement

Effective July 21, 2006, the Company entered into a service agreement with Leucadia National Corporation whereby the Company and Leucadia agreed to perform certain services for each other for charges based on services provided. This agreement was non-disapproved by the Department on July 10, 2006.

Sub-lease Agreement

Effective September 1, 2005, the Company entered into a sublease agreement with Leucadia for office space for its home office. This lease expires on December 30, 2009 and was non-disapproved by this Department on October 3, 2005.

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. Significant Operating Ratios

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

Net premiums written in 2006 to surplus as regards policyholders	.126:1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	52.90%
Premiums in course of collection to surplus as regards policyholders	.037%

All of the above ratios falls 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 three-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$(33,684,269)	(624.08)%
Other underwriting expenses incurred	15,145,705	280.61
Net underwriting gain	<u>23,936,011</u>	<u>443.47</u>
Premiums earned	<u>\$5,397,447</u>	<u>100.00%</u>

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, 2006. This statement is the same as the balance sheet filed by the Company.

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$ 102,462,688	\$ 0	\$ 102,462,688
Cash and short-term investments	9,443,803	0	9,443,803
Other invested assets	363,620	0	363,620
Investment income due and accrued	1,631,571	0	1,631,571
Uncollected premiums and agents' balances in course of collection	21,354	0	21,354
Amounts recoverable from reinsurers	352,182	0	352,182
Other amounts receivable under reinsurance contracts	183,994	0	183,994
Net deferred tax assets	79,698,242	79,698,242	0
Aggregate write-ins for other than invested assets	<u>12,427,049</u>	<u>9,470,158</u>	<u>2,956,891</u>
Total assets	<u>\$206,584,503</u>	<u>\$89,168,400</u>	<u>\$117,416,103</u>

Liabilities, Surplus and Other FundsLiabilities

Losses and loss adjustment expenses		\$48,357,513
Other expenses (excluding taxes, licenses and fees)		1,938,679
Taxes, licenses and fees (excluding federal and foreign income taxes)		(92,779)
Current federal and foreign income taxes		346,543
Unearned premiums		292,117
Ceded reinsurance premiums payable (net of ceding commissions)		153,153
Amounts withheld or retained by company for account of others		134
Provision for reinsurance		1,850,399
Payable to parent, subsidiaries and affiliates		2,471,889
Aggregate write-ins for liabilities		<u>4,089,339</u>
Total liabilities		\$59,406,987

Surplus and Other Funds

Common capital stock	\$ 11,309,200	
Gross paid in and contributed surplus	52,143,276	
Unassigned funds (surplus)	<u>(5,443,360)</u>	
Surplus as regards policyholders		<u>58,009,116</u>
Total liabilities, surplus and other funds		<u>\$117,416,103</u>

NOTE: The Internal Revenue Service (“IRS”) has completed its audits of the consolidated tax returns filed on behalf of the Company through tax year 1999. 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. Audits covering tax years 2000 to 2006 have yet to commence. 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 increased \$46,100,111 during the period January 1, 2004 through December 31, 2006 detailed as follows:

Underwriting Income

Premiums earned		\$ 5,397,447
Deductions:		
Losses incurred	\$(42,100,580)	
Loss adjustment expenses incurred	8,416,311	
Other underwriting expenses incurred	16,555,677	
Aggregate write-ins for underwriting deductions	<u>(1,409,972)</u>	
Total underwriting deductions		<u>(18,538,564)</u>
Net underwriting gain or (loss)		\$23,936,011

Investment Income

Net investment income earned	\$ 15,395,048	
Net realized capital gains	<u>2,421,440</u>	
Net investment gain or (loss)		17,816,488

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (95,228)	
Finance and service charges not included in premiums	5,920	
Aggregate write-ins for miscellaneous income	<u>3,406,280</u>	
Total other income		<u>3,316,972</u>
Net income before dividends to policyholders and before federal and foreign income taxes		\$ 45,069,471
Dividends to policyholders		<u>0</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$ 45,069,471
Federal and foreign income taxes incurred		<u>1,177,296</u>
Net income		<u>\$ 43,892,175</u>

C. Capital and Surplus Account

Surplus as regards policyholders per report on examination as of December 31, 2003			\$11,909,005
	<u>Gains in</u>	<u>Losses in</u>	
	<u>Surplus</u>	<u>Surplus</u>	
Net income	\$43,892,175		
Net unrealized capital gains or (losses)	0	\$617,510	
Change in net deferred income taxes	0	16,856,014	
Change in non-admitted assets	20,875,665		
Change in provision for reinsurance		848,798	
Aggregate write-ins for gains and losses in surplus		345,407	
	_____	_____	
Total gains and losses	<u>\$64,767,840</u>	<u>\$ 18,667,729</u>	
Net increase in surplus as regards policyholders			<u>46,100,111</u>
Surplus as regards policyholders per report on examination as of December 31, 2006			\$ <u>58,009,116</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items in the amount of \$48,357,513 is the same amount as reported by the Company as of December 31, 2006. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Company's internal records and in its filed annual statements.

5. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business 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.

No problems were encountered.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination as of December 31, 2003 contained comments and recommendations as follows (page numbers refer to the prior report):

<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
The Company has not complied with this recommendation a similar comment is contained in this report.	
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
The Company has complied with this recommendation.	
ii. It is recommended the Company's board of directors ratify its tax allocation agreement.	10
The Company has not complied with this recommendation. A similar comment is made in this report.	
iii. It is also recommended that the Company amend its tax allocation agreement to include its immediate parent, BellPet, Inc., as a party to the agreement, pursuant to Circular Letter No. 33 (1979).	10
The Company has not complied with this recommendation. A similar recommendation is contained in this report.	

<u>ITEM</u>		<u>PAGE NO.</u>
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 Examiners Handbook.	13
	The Company has complied with this recommendation.	
ii.	It is also recommended that the Company take due care to correctly complete the General Interrogatories in its filed annual statement.	13
	The Company has complied with this report	
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
	This dispute was settled by the Company on April 13, 2005 with a payment, including interest, of \$2,543,239.	
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.	16
	The Company has complied with this recommendation.	
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.	16
	The Company has complied with this recommendation.	
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.	16
	The Company has complied with this recommendation.	

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>		<u>PAGE NO.</u>
A.	<u>Management</u>	
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B.	<u>Holding Company System</u>	
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Respectfully submitted,

_____/s/_____
Jainarine Tilakdharry
Senior Insurance Examiner

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

JAINARINE TILAKDHARRY, 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/_____
Jainarine Tilakdharry

Subscribed and sworn to before me

this _____ day of _____ 2008.

STATE OF NEW YORK
INSURANCE DEPARTMENT

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

Jainarine Tilakdharry

as proper person to examine into the affairs of the

EMPIRE INSURANCE COMPANY

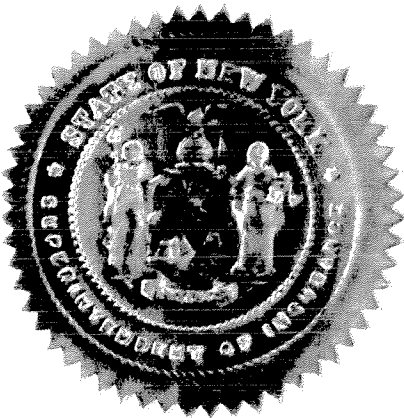
and to make a report to me in writing of the condition of the said

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 13th day of September, 2007



A handwritten signature in cursive script, appearing to read "Eric R. Dinallo".

ERIC R. DINALLO
Superintendent of Insurance