

REPORT ON EXAMINATION
OF THE
EMPIRE INSURANCE COMPANY
AS OF
DECEMBER 31, 2011

DATE OF REPORT

January 9, 2013

EXAMINER

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TABLE OF CONTENTS

<u>ITEM NO.</u>		<u>PAGE NO.</u>
1.	Scope of examination	2
2.	Description of Company	3
	A. Management	4
	B. Territory and plan of operation	5
	C. Reinsurance	6
	D. Holding company system	6
	E. Significant operating ratios	9
3.	Financial Statements	10
	A. Balance sheet	10
	B. Statement of income	11
4.	Losses and loss adjustment expenses	12
5.	Compliance with prior report on examination	13
6.	Summary of comments and recommendations	13



NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Benjamin M. Lawsky
Superintendent

January 9, 2013

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 30835 dated February 21, 2012 attached hereto, I have made an examination into the condition and affairs of Empire Insurance Company as of December 31, 2011, and submit the following report thereon.

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

Wherever the designation “Parent” or “Leucadia” appears herein without qualification, it should be understood to indicate Leucadia National Corporation.

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 315 Park Ave South, 18th Floor, New York NY 10010.

1. SCOPE OF EXAMINATION

The Department has performed an individual examination of the Company, a multi-state insurer. The previous examination was conducted as of December 31, 2006. This examination covered five year period from January 1, 2007 through December 31, 2011. 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. 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
- Fidelity bonds and other insurance
- Territory and plan of operation
- Loss experience
- Reinsurance
- Accounts and records
- 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

Empire Insurance Company is a property and casualty insurer incorporated under the laws of the State of New York as Red Cab Mutual Casualty Company on February 6, 1925. It commenced business on 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. The Company merged with its wholly-owned subsidiary, Centurion Insurance Company, effective December 31, 2001 and with another wholly-owned subsidiary, Allcity Insurance Company, on December 31, 2003, with Empire as the surviving company in both instances.

Effective December 31, 2001, the Company commenced an orderly voluntary run-off of all its operations in the best interest of its shareholders and policyholders. As of the examination date, the Company's common shares are 100% owned and controlled through subsidiaries of Leucadia National Corporation ("Leucadia").

Historically, the Company specialized in commercial and personal property and casualty insurance primarily in the New York metropolitan area. The Company offered insurance products for automobile insurance coverage, general liability coverage, property coverage and workers; compensation to commercial accounts and private passenger automobile and homeowners products to individuals.

As of December 31, 2011, the Company's Gross paid in and contributed surplus is \$0 and common capital stock was \$1,000,322 comprising of 19,515 shares with par value of \$51.259133. Gross paid in and contributed surplus and capital stock decreased during the examination period through a series of stock redemption and retirement transactions which were approved by the Department. The changes are illustrated as follows:

<u>Year</u>	<u>Description</u>	<u>Amount</u>
2007	Gross paid in and contributed surplus	\$52,143,276
2008	Gross paid in and contributed surplus	\$17,228,440
2009	Gross paid in and contributed surplus	\$ 9,854,142
2010	Gross paid in and contributed surplus	\$ 1,499,849
2011	Gross paid in and contributed surplus	\$ 0

Common capital stock decreased during the examination period as follows:

<u>Year</u>	<u>Description</u>	<u>Amount</u>
2007	Common capital stock	\$11,309,200
2008	Common capital stock	\$ 4,610,600
2009	Common capital stock	\$ 3,402,000
2010	Common capital stock	\$ 2,247,600
2011	Common capital stock	\$ 1,000,322

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 seven nor more than twelve members. The board meets at least one time during each calendar year. At December 31, 2011, the board of directors was comprised of the following twelve members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Cannella, Philip M. Pelham, NY	Assistant Vice President and Tax Director, Leucadia National Corporation
Cumming, Ian M. Jackson, WY	Director, Leucadia National Corporation
Jordan, James E. New York, NY	Private investor, Self employed
Mara, Thomas E. Franklin Lake, NJ	Executive Vice President, Leucadia National Corporation
Nittoli, Rocco J. Matawan, NJ	Vice President & Treasurer, Leucadia National Corporation
O'Connor, Joseph M. Darien, CT	Vice President, Leucadia National Corporation
Orlando, Joseph A. Harrison, NY	Vice President & Chief Financial Officer, Leucadia National Corporation
Siracusano, Louis V. Ocoee, FL	Of Counsel, Law Offices of Albert W. Chianese
Steinberg, Joseph S. Brooklyn, NY	Chairman, Leucadia National Corporation

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Ulbrandt DiPierro, Laura E. Peekskill, NY	Assistant Vice President & Corporate Secretary, Leucadia National Corporation
Whitenack, Douglas M. Eatontown, NJ	President, Chief Executive Officer & Treasurer, Empire Insurance Company
Wise, Harry H. New York, NY	President, HW 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.

As of December 31, 2011, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Rocco Joseph Nittoli	Chairman
Douglas Martin Whitenack	President & CEO, Treasurer and Director
Lisa Marie Muscarella	Vice President and Corporate Secretary

B. Territory and Plan of Operation

As of December 31, 2011, the Company was licensed to write business in New York, Connecticut, Massachusetts, Missouri, New Hampshire and New Jersey. Due to the Company's run-off status, Empire's Missouri certificate was suspended on April 15, 2002. The Company was ordered not to write any new or renewal business in New Hampshire effective September 12, 2002.

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
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
10	Elevator
11	Animal
12	Collision
13	Personal injury liability
14	Property damage liability

<u>Paragraph</u>	<u>Line of Business</u>
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

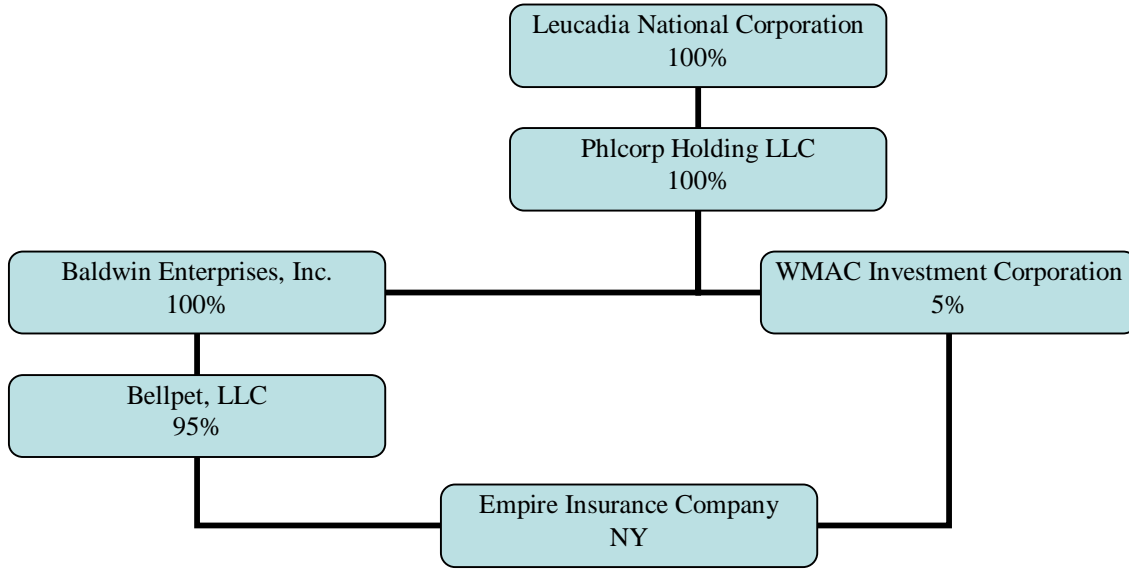
Due to the Company's run-off status, the last reinsurance contract was non-renewed in 2001.

Examination review found that the Schedule F data reported by the Company in its filed annual statement accurately reflected its reinsurance transactions.

D. Holding Company System

Empire Insurance Company is 100% owned and controlled, through various subsidiaries, by Leucadia National Corporation. Leucadia National Corporation, whose common stock shares are traded on the New York Stock Exchange, is a diversified holding company. It engages, through its consolidated subsidiaries, in a variety of businesses including manufacturing, land-based contract oil and gas drilling, gaming entertainment, real estate activities, medical product development, winery operations and beef processing. 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 except that the Company did not file the annual holding company registration statement in 2007.

The following is an abridged chart of the holding company system at December 31, 2011 reflecting only the Company's direct parents:



At December 31, 2011, the Company was a party to the following agreements with other members of its holding company system:

Tax Allocation Agreement

Effective January 1, 2001, the Company was a party to the Tax Allocation Agreement with Leucadia. Pursuant to the Agreement, the Company, Leucadia and other subsidiaries of Leucadia are required to file their federal income tax returns on a consolidated basis and allocate by the ratio of separate return tax liability of each company in the Group bears to the sum of the separate return tax liabilities of all the companies in the Group.

An amendment made on February 27, 2008 included the Company's intermediate parent, BELLPET, LLC, as a party to the agreement. The amendment, effective for all tax periods beginning after December 31, 2006, was reviewed and approved by the Board on March 3, 2008. The Tax Allocation Agreement and the amendment were on file with the Department.

Service Agreement

The Company entered the Service Agreement with Leucadia on July 21, 2006. Pursuant to the Agreement, Leucadia shall provide the Company with employee benefit plans, group insurance plans and corporate insurance coverage. The Company and Leucadia shall provide other services to each other subject to each other's possession of appropriate resources and availability of personnel. The Agreement was approved by the Department on July 10, 2006.

Sublease Agreement

The Sublease Agreement was made on December 16, 2009 between the Company and Leucadia having an office at 315 Park Ave South 20th Floors, New York, NY. An Amendment to the Sublease was made on June 30, 2012 to adjust the fixed rent per month effective July 1, 2012. Both the Agreement and the Amendment did not require the Department's approval since the aggregate payments to be made under the proposed lease were less than one percent of Empire's admitted assets at prior year end according to Part 80 - 1.5(c)(2) of New York Insurance Regulation 52.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2011, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	0%*
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	54.13%
Premiums in course of collection to surplus as regards policyholders	0%*

*Both Net premiums written to surplus as regards policy-holders ratio and premiums in course of collection to surplus as regards policyholders ratio are zero due to the Company's run-off status.

Liability to liquid assets ratio 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 five year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	(\$10,133,672)	(902.93)%
Other underwriting expenses incurred	13,977,890	1,245.46
Net underwriting loss	<u>(2,721,910)</u>	<u>(242.53)</u>
Premiums earned	<u>\$1,122,308</u>	<u>100.00%</u>

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2011 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	\$23,504,344	\$ 0	\$23,504,344
Cash, cash equivalents and short-term investments	12,883,572	0	12,883,572
Investment income due and accrued	107,960	0	107,960
Amounts recoverable from reinsurers	1,013,983	0	1,013,983
Other amounts receivable under reinsurance contracts	367,182	367,182	0
Employee retention trust account	183,974	0	183,974
Equities and deposits in pools and associations	209,513	0	209,513
Prepaid expenses	58,314	58,314	0
Receivable from subtenants	429,613	0	429,613
Sublease assets	5,270,035	5,270,035	0
Receivable from RAMIUS LP	78,346	0	78,346
Miscellaneous	(2,018)	(2,018)	0
Totals	<u>\$44,104,818</u>	<u>\$5,693,513</u>	<u>\$38,411,305</u>
Liabilities, surplus and other funds			
Losses and Loss Adjustment Expenses			\$17,215,447
Other expenses (excluding taxes, licenses and fees)			499,789
Taxes, licenses and fees (excluding federal and foreign income taxes)			21,469
Current federal and foreign income taxes			28,526
Unearned premiums			835
Ceded reinsurance premiums payable (net of ceding commissions)			131,775
Funds held by company under reinsurance treaties			57,510
Amounts withheld or retained by company for account of others			669
Provision for reinsurance			849,234
Payable to parent, subsidiaries and affiliates			58,596
Aggregate write-ins for liabilities			889,371
Total liabilities			<u>\$19,753,221</u>
Common capital stock		\$ 1,000,322	
Unassigned funds (surplus)		<u>17,657,762</u>	
Surplus as regards policyholders			<u>\$18,658,084</u>
Totals			<u>\$38,411,305</u>

Note: The Internal Revenue Service has not completed its audits of the Leucadia National Corporation's consolidated Federal Income Tax returns through tax year 2011. 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. Statement of Income

Surplus as regards policyholders decreased by \$39,351,032 during the five-year examination period January 1, 2007 through December 31, 2011, detailed as follows:

Underwriting Income

Premiums earned		\$ 1,122,308
Deductions:		
Losses and loss adjustment expenses incurred	\$(10,133,672)	
Other underwriting expenses incurred	13,976,826	
Aggregate write-ins for underwriting deductions	<u>1,064</u>	
Total underwriting deductions		<u>3,844,218</u>
Net underwriting gain or (loss)		\$(2,721,910)

Investment Income

Net investment income earned	\$ 16,707,831	
Net realized capital gain	<u>5,878,267</u>	
Net investment gain or (loss)		22,586,098

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ 298,564	
Finance and service charges not included in premiums	280	
Sublease rental income	7,350,713	
Other income	<u>1,149,966</u>	
Total other income		<u>8,799,523</u>

Net income after dividends to policyholders but before federal and foreign income taxes		\$28,663,711
Federal and foreign income taxes incurred		<u>614,170</u>
Net Income		<u>\$28,049,541</u>

Surplus as regards policyholders per examination as of December 31, 2006

	Gains in <u>Surplus</u>	Losses in <u>Surplus</u>	
Net income	\$ 28,049,541		\$ 58,009,116
Net unrealized capital gains or (losses)		\$ 38,000	
Change in net deferred income tax		80,203,806	
Change in nonadmitted assets	83,980,451		
Change in provision for reinsurance	1,001,165		
Capital changes paid in		10,308,878	
Surplus adjustments paid in		52,143,277	
Dividends to stockholders		10,033,634	
Aggregate write-ins for gains and losses in surplus	<u>345,406</u>	<u>0</u>	
Net increase (decrease) in surplus	<u>\$113,376,563</u>	<u>\$152,727,595</u>	<u>\$(39,351,032)</u>

Surplus as regards policyholders per examination as of December 31, 2011

\$ 18,658,084

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$17,215,447 is the same as reported by the Company as of December 31, 2011. 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.

The actuarial review indicated that the Company reported Schedule P Part 2 of its 2011 Annual Statement on a net of tabular discount basis, which is not consistent with the NAIC Annual Statement Instruction for P&C Companies, as displayed in the footnote of Schedule P Part 1 Summary of the Annual statement. The Footnote states in part, "Parts 2 and 4 are gross of all discounting, including tabular discounting."

It is recommended that the Company report Schedule P Part 2 on a gross of discount basis in the future.

The actuarial review also revealed that the Company reduced its known case reserves by the total known case and IBNR anticipated salvage and subrogation amount of \$6.785 million, which included \$1.5 million of projected recoveries on IBNR reserves.

It is recommended that the Company reduce its known case reserves only by the amount of anticipated salvage and subrogation attributable to the projected recoveries on known case reserves and, similarly, IBNR reserves should only be reduced by the amount of projected salvage and subrogation recoveries which are attributable to the IBNR reserve.

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
It is recommended that the Company require all directors and officers to sign conflict of interest affidavits on an annual basis.	5
The Company has complied with this recommendation.	
B. <u>Holding Company System</u>	
It is recommended that the Company's board of directors ratify its tax allocation agreement.	9
The Company has complied with this recommendation.	
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).	9
The Company has complied with this recommendation.	

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
I. It is recommended that the Company report Schedule P Part 2 of its Annual Statement on a gross of discount basis going in the future.	12
II. It is recommended that the Company reduce its known case reserves only by the amount of anticipated salvage and subrogation attributable to the projected recoveries on known case reserves and, similarly, IBNR reserves should only be reduced by the amount of projected salvage and subrogation recoveries which are attributable to the IBNR reserve.	12

Respectfully submitted,

_____/s/
Wei Cao
Senior Insurance Examiner

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

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

_____/s/
Wei Cao

Subscribed and sworn to before me

this _____ day of _____, 2013.

NEW YORK STATE

DEPARTMENT OF FINANCIAL SERVICES

I, BENJAMIN M. LAWSKY, Superintendent of Financial Services of the State of New York, pursuant to the provisions of the Financial Services Law and the Insurance Law, do hereby appoint:

Wei Cao

as a proper person to examine the affairs of the

EMPIRE INSURANCE COMPANY

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

COMPANY

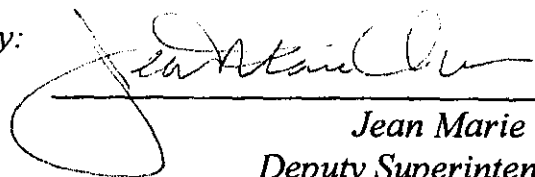
with such other information as she shall deem requisite.

*In Witness Whereof, I have hereunto subscribed my name
and affixed the official Seal of the Department
at the City of New York*

this 21st day of February, 2012

BENJAMIN M. LAWSKY
Superintendent of Financial Services

By:



Jean Marie Cho
Deputy Superintendent

