REPORT ON EXAMINATION

OF THE

HEREFORD INSURANCE COMPANY

AS OF

DECEMBER 31, 2006

DATE OF REPORT	APRIL 15, 2008
EXAMINER	DILBRINA BELGRAVE

TABLE OF CONTENTS

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

April 15, 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 22653 dated June 13, 2007 attached hereto, I have made an examination into the condition and affairs of Hereford Insurance Company as of December 31, 2006, and submit the following report thereon.

Wherever the designations “the Company” or “Hereford” appear herein without qualification, they should be understood to indicate Hereford 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 36-01 43rd Avenue, Long Island City, NY 11101.

1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 2002. This examination covered the four-year period from January 1, 2003 through December 31, 2006. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination comprised a 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 certified public accountants ("CPA"). 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 on October 5, 1982 and commenced business on April 1, 1986.

At December 31, 2006, capital paid in was $1,000,000 consisting of 1,000,000 shares of common stock at $1 par value per share. Gross paid in and contributed surplus was $709,200, which remains unchanged from the prior 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 thirteen nor more than twenty-one members. The board met annually during each calendar year. At December 31, 2006, the board of directors was comprised of the following thirteen members:

Name and Residence	Principal Business Affiliation
Vincent Bitet Smithtown, NY	President, Bitet Insurance Brokerage
Paul Boucher Pocono Summit, PA	Retired, Political Consultant
Richard Chin Wantagh, NY	Chief Operating Officer, Pearland Brokerage
Karen Greenbaum Roslyn, NY	Senior Vice President, Hereford Insurance Company
Neil Greenbaum Roslyn, NY	President, Hereford Insurance Company
Pearl Greenbaum Boyton Beach, FL	Retired Treasurer, Hereford Insurance Company
Eugene Haber Roslyn, NY	Partner, Colbert, Haber & Haber
Barbara Hamill Avon, CT	Vice President, Hereford Insurance Company

Name and Residence	Principal Business Affiliation
John Hamill Avon, CT	President, Suburban Greater Hartford Realty Mgmt. Corp.
Lisa Kuba Syosset, NY	Vice President, Hereford Insurance Company
David Pollack Washingtonville, NY	Executive Director, Committee for Taxi Safety
Anne Schulman New Hyde Park, NY	Treasurer, Hereford Insurance Company
Annie Weinstein, Baldwin, NY	Senior Vice President & Chief Operating Officer Hereford Insurance Company

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended by board members either by actual attendance or by telecommunication. However the minutes of the board of directors' meetings did not indicate that the investments made by Hereford Insurance Company were approved by the Company's board of directors. Section 1411(a) of the New York Insurance Law states, in pertinent part:

> "No domestic insurer shall make any loan or investment, except as provided in subsection (h) hereof, unless authorized or approved by its board of directors or a committee thereof responsible for supervising or making such investment or loan. The committee's minutes shall be recorded and a report submitted to the board of directors at its next meeting."

It is recommended that the Company record any investment approval in its committee minutes pursuant to Section 1411(a) of the New York Insurance Law. A similar recommendation was made in the prior report on examination.

As of December 31, 2006, the principal officers of the Company were as follows:

Name	Title
Neil Greenbaum	President and Secretary
Anne Schulman	Treasurer
Karen Greenbaum	Senior Vice President
Barbara Hamill	Vice President
Annie Weinstein	Senior Vice President

The prior report on examination contained a recommendation that the Company comply with Article IV, Sections 4 and 7 of its by-laws by having its vice presidents and treasurer be full-time active members of the Company's executive management and fulfill their duties, as indicated in the Company's by-laws, as officers of the Company.

Upon review of the Company's by-laws and principal officers, it was noted that senior vice president Karen Greenbaum and vice president Barbara Hamill were not full-time employees of the Company.

It is again recommended that the Company comply with Article IV, Section 4 of its by-laws by having its vice presidents be full-time active members of the Company's executive management and fulfill their duties, as indicated in the Company's by laws, as officers of the Company.

Fidelity Coverage

The prior report on examination contained a recommendation that the Company obtain adequate fidelity bond coverage commensurate with its exposure.

A review of the Company's fidelity bond currently in force indicated that the bond's limit of liability was insufficient based on the Company's exposure. According to the NAIC Financial Condition Examiners Handbook, the Company's fidelity bond coverage should be within the range of $600,000 to $700,000.

It is again recommended that the Company obtain adequate fidelity bond coverage commensurate with its exposure.

B. Territory and Plan of Operation

As of December 31, 2006, the Company was licensed to write business only in the State of New York.

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:

Paragraph	Line of Business
8	Glass
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
19	Motor vehicle and aircraft physical damage

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 $1,300,000.

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

Calendar Year	Direct Premiums Written
2003	$49,520,895
2004	$63,259,445
2005	$76,017,956
2006	$81,757,354

The Company utilizes a network of brokers for the production of business. The majority of the business is written through Pearland Brokerage ("Pearland"). Pursuant to the provisions of Department Regulation 52-A, Pearland is deemed a controlling producer of the Company. This is further discussed in Item 2D, "Holding Company System".

C. Reinsurance

Assumed reinsurance accounted for a small amount of the Company's gross premiums written as of December 31, 2006. All insurers writing automobile insurance in this state must participate in the New York Automobile Insurance Plan ("NYAIP"). NYAIP is the central mechanism established pursuant to Article 53 of the New York Insurance Law to provide auto liability and physical damage coverages to those insureds that are unable to obtain such auto insurance in the voluntary market. The Company's assumed reinsurance represents its participation in this mandated market. It appears that the company is not accounting for its participation in

NYAIP in accordance with the NAIC Accounting Practices and Procedures Manual, Statements of Statutory Accounting Principles ("SSAP") No. 63.

SSAP No 63 paragraph 8 states in part:

> "If the reporting entity is a direct writer of the business, premiums shall be recorded as directly written and accounted for in the same manner as other business which is directly written by the entity."

It is recommended that the Company properly account for its NYAIP participation in accordance with SSAP No. 63, paragraph 8 of the NAIC Accounting Practices and Procedures Manual.

The company has structured its ceded reinsurance program to limit its maximum exposure to any one risk as follows:

Workers' Compensation

The Company designed a ceded reinsurance program for its workers' compensation business to limit its maximum exposure in any one risk to $40,000. The Company maintains a quota share agreement, whereby the Company cedes 60% of the first $100,000 of its workers' compensation insurance to a non-affiliated, authorized reinsurer. The Company also maintains three excess of loss treaties between authorized reinsurers with the following layers of coverage: First excess of loss agreement with coverage of $1,150,000 in excess of $100,000; second excess of loss agreement with coverage of $4,750,000 in excess of $1,250,000; third excess of loss agreement with coverage of $4,000,000 in excess of $6,000,000.

Commercial Automobile

The Company obtained reinsurance for its commercial automobile business as follows:

Voluntary Commercial Automobile quota share	65% with a combined single limit of $300,000.
Involuntary Commercial Automobile quota share	60% with a combined single limit of $500,000.
Per occurrence excess of loss - Extra contractual obligations and excess of policy limits awards only on Automobile Liability Insurance for all NY Taxis, and business accepted under A.I.P.S.O.	$250,000 excess of $250,000 each occurrence, limit $500,000.

Per occurrence excess of loss - Automobile Liability business written under A.I.P.S.O. and up to a maximum of 10 New York Livery units	$200,000 excess of $300,000 each occurrence, limit $400,000. Nevertheless, the first $175,000 otherwise recoverable shall be retained by the reinsured for its own account and the otherwise recoverable shall increase by $25,000 at each anniversary date.
Per occurrence excess of loss - Automobile Liability Insurance for all NY Taxis and business accepted under A.I.P.S.O.	$500,000 excess of $500,000 each occurrence, limit $1,000,000.
Per occurrence excess of loss – Automobile Liability Insurance for all NY Taxis and business accepted under A.I.P.S.O.	$1,000,000 excess of $1,000,000 each occurrence, limit $2,000,000.

All ceded reinsurance agreements in effect as of December 31, 2006 were reviewed. All of the Company’s reinsurance agreements contained the required clauses, including insolvency clause pursuant to Section 1308 of the New York Insurance Law with the exception of one agreement.

During a review of the Company’s workers’ compensation agreements, it was noted that the worker’s compensation second and third layer, excess of loss agreements and the per policy excess of loss reinsurance agreement lacked the required terms as prescribed by NAIC Accounting Practices and Procedures Manual, Statements of Statutory Accounting Principles (“SSAP”) No. 62, paragraph 8(d), which states in part the following:

> “The agreement must provide for reports of premiums and losses, and payment of losses, no less frequently than on a quarterly basis, unless there is no activity during the period. The report of premiums and losses shall set forth the ceding entity’s total loss and loss expense reserves on the policy obligations subject to the agreement, so that the respective obligations of the ceding entity and reinsurer will be recorded and reported on a basis consistent with this statement”

It is recommended that the Company amend its workers’ compensation second and third layer excess of loss and per policy excess of loss agreements to include all of the required language pursuant to SSAP No. 62, paragraph 8 of the NAIC Accounting Practices and Procedures Manual.

It was further noted that the Company purchased its per policy excess of loss agreement at the behest of its quota share reinsurer. The quota share reinsurer agreed to share in the expense of procuring this coverage. As a result, the Company reduces its ceded reinsurance premiums payable by $391,750 which represents the quota share reinsurer’s portion of the premium. This condition of procuring the Company quota share agreement was evident in the cover note to the contract; however this arrangement was not included in the executed quota share reinsurance agreement.

It is recommended that the Company amend its taxi liability quota share reinsurance agreement to include all terms and conditions agreed upon by both parties pursuant to Department Circular Letter No. 8 (2005).

Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's chief executive officer pursuant to the NAIC Annual Statement Instructions. Additionally, examination review indicated that the Company was not a party to any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in SSAP No. 62 of the NAIC Accounting Practices and Procedures Manual except the aforementioned per policy excess of loss reinsurance agreement.

Provisional Commissions

Under its workers' compensation quota share agreement, the reinsurer allows the Company a 20% provisional ceding commission on the ceded net subject premiums. The provisional ceding commission becomes adjustable on a sliding scale basis upward or downward contingent on the Company's loss ratios. The provisional ceding commission may reach a maximum of 40% on a 30% Company loss ratio or reduce to a low of 15% subject to an 80% Company loss ratio.

Under the liability quota share agreement, there is a 28% initial provisional ceding commission with sliding scale adjustments of upwards to 45% maximum ceding commissions on a Company loss ratio of 28% and a minimum ceding commission of 18% subject to a 79% loss ratio by the Company.

The ceding commissions allowed under these agreements enabled the Company to report ceding commission income of approximately $4,000,000 during calendar year 2006. This caused the Company to score a value of 27% on the "Surplus aid to surplus" ratio, which exceeded the benchmark of 15% established by the National Association of Insurance Commissioners. This is the sixth consecutive year that the Company exceeded the NAIC benchmark for this ratio. Users of the

Company’s financial statements should be aware of the possible distortive effects of ceding commission income on the Company’s surplus position.

D. Holding Company System

The Company is a wholly-owned subsidiary of Hereford Holding Corporation (“HHC”), a non-operating New York shell corporation, which is ultimately controlled by the Greenbaum Family. The majority interest in HHC is held by Hereford Insurance Company’s president, Neil Greenbaum, who directly owns 50% of HHC stock, with an additional 30% controlled by other immediate family members. Mr. Greenbaum also holds 10% interest in Pearland Brokerage, which is the Company’s primary producer. In addition to his insurance operation, Mr. Greenbaum owns other businesses, including a fleet of medallion automobiles and medallion management services for entrepreneurs in New York City. All of Mr. Greenbaum’s businesses are operated at the same Long Island City location as Hereford Insurance Company.

The prior report on examination contained a recommendation that the Company should fully comply with Department Regulation 52-A by filing in a timely manner its controlling producer report no later than April 1st of each year as required.

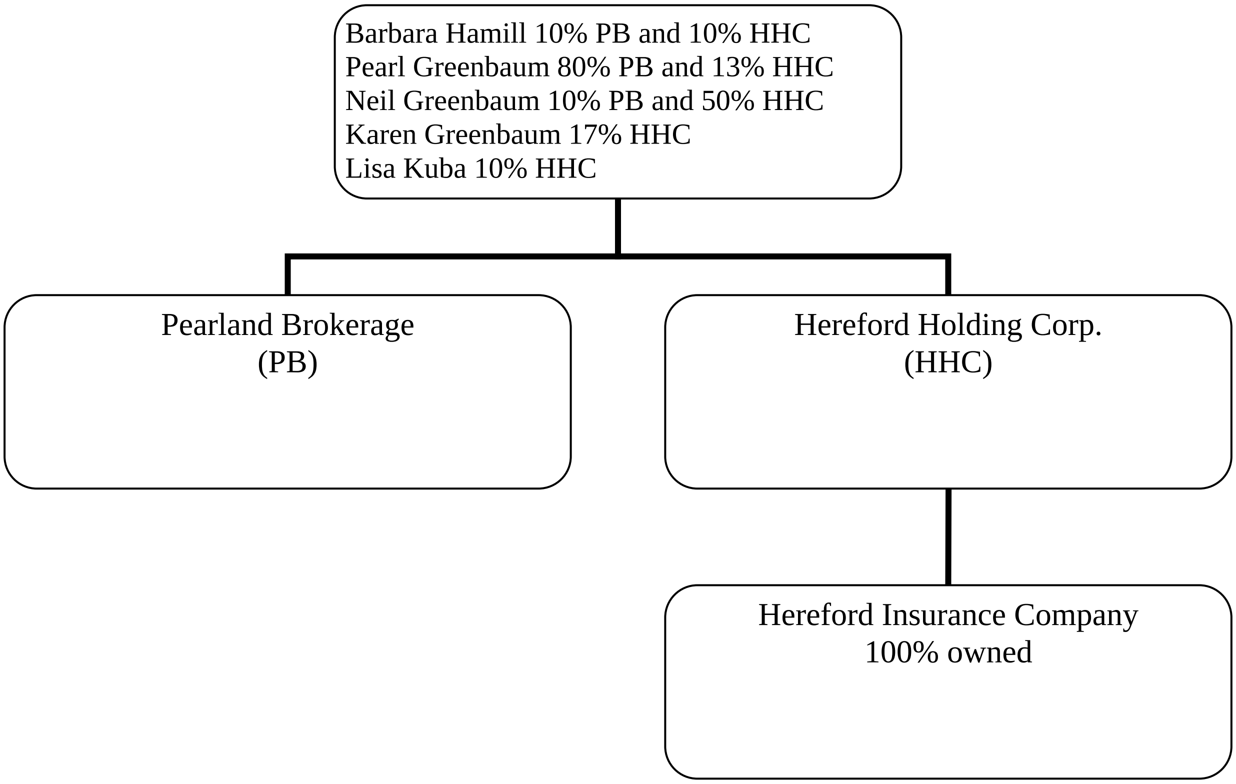
Pursuant to Part 80-2.2 of Department Regulation 52-A:

> “a controlled insurer in any calendar year receiving from a controlling producer total gross written premiums equal to or greater than five percent of the admitted assets of the controlled insurer as reported in the quarterly financial statement filed as of September 30th of the prior year, is subject to reporting requirements prescribed herein with the superintendent on or before each April 1st.”

A review of the holding company registration statements filed with this Department indicated that the Company failed to file its required reports in a timely manner.

It is again recommended that the Company fully comply with Department Regulation 52-A by filing in a timely manner its controlling producer report no later than April 1st of each year as required.

The following is a chart of the holding company system at December 31, 2006:



At December 31, 2006, the Company was party to the following agreements with other members of its holding company system:

Brokerage Agreement

Effective February 12, 1998 and amended June 27, 2003, the Company entered into an agreement with its controlling producer, Pearland Brokerage, to place business for the Company. This agreement was filed with this Department pursuant to Section 1505 of the New York Insurance Law.

Commercial Lease

Effective April 1, 2004, the Company entered into an agreement with its affiliate, Thirty Sixty O One, LLC, to rent office and parking space. Under the agreement, the Company agreed to rent the entire second floor and parking space located at 36-01 43rd Avenue, Long Island City, New York, for the term of three years. This agreement was not filed with this Department pursuant to Section 1505 of the New York Insurance Law.

Effective May 1, 2006, the Company entered into another agreement with its affiliate, Thirty Sixty O One, LLC, to rent office and parking space. Under the agreement, the Company agreed to rent approximately eighty percent of the third floor and parking space located at 36-01 43rd Avenue, Long Island City, New York, for the term of three years. This agreement was not filed with this Department pursuant to Section 1505 of the New York Insurance Law.

Subsequent to the date of this examination, the Company entered into another agreement with its affiliate, Thirty Sixty O One, LLC, to combine the two aforementioned agreements. Effective April 1, 2007, for a period of three years, the Company agreed to rent the entire second floor, approximately eighty percent of the third floor and parking spaced located at 36-01 43rd Avenue, Long Island City, New York, for the term of three years. This agreement was not filed with this Department pursuant to Section 1505 of the New York Insurance Law.

It is recommended that the Company file its lease agreement with the Department in accordance with Section 1505(d) of the New York Insurance Law.

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 to surplus as regards policyholders	2.06:1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	84%
Premiums in course of collection to surplus as regards policyholders	8%

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 three-year period covered by this examination:

	Amounts	Ratios
Losses and loss adjustment expenses incurred	$55,801,722	83.07%
Other underwriting expenses incurred	(2,130,259)	(3.17)
Net underwriting gain	13,499,218	20.10
Premiums earned	$67,170,681	100.00%

F. Accounts and Records

The Company’s investments, reinsurance and loss accounts reporting are handled by the Company’s outside accountant, reinsurance intermediary and actuary, respectively. The cash accounts and general ledger functions are performed by in-house staff. Based on a review of the Company’s accounts and records, the following discrepancies were noted:

(i) Cash On Hand

It was recommended in the prior report on examination that signatories for the bank accounts be restricted to include only full time employees and that all signatories be approved by the Board of Directors. Upon review of the bank confirmation received by the Department, it appears that the company’s account continues to have a non-employee as a signatory on the bank accounts. Section 1411(b) of the New York Insurance Law states in part:

“The disposition of the insurer's property is the responsibility of its Board of Directors…”

Since the signatories on company accounts are approved by the board of directors, the continued permission by the Board of Directors for non-employees to access company accounts as signatories is not consistent with Section 1411(b) of the New York Insurance Law.

It is recommended that the company comply with Section 1411(b) of the New York Insurance Law and restrict its signatory access to the company’s bank accounts to employees.

(ii) Investment Accounts

The prior report on examination contained the following recommendations:

- It is recommended that the Company amend its existing custodial agreement to incorporate the standard protective clauses prescribed by the NAIC and also acknowledged by the Department as good public policy.

- It is recommended that the Company implement a separate custodial agreement with North Fork Bank (“NFB”) applicable to Company investments both managed and held by NFB, pursuant to the parties’ investment management agreement.

During a review of the Company’s custodial agreements, it was noted that the Company did not amend its existing custodial agreement with Bank of America (formerly Fleet Bank) or implement a separate custodial agreement with Capital One Bank (formerly North Fork Bank).

Therefore, it is again recommended that the Company amend its existing custodial agreement to incorporate the standard protective clauses prescribed by the NAIC Examiners Financial Condition Handbook and also acknowledged by the Department as good public policy.

Furthermore, it is again recommended that the Company implement a separate custodial agreement with Capital One Bank applicable to the Company’s investments both managed and held by Capital One Bank pursuant to the parties’ investment management agreement.

(iii) Agent’s Balances

During the review of the Company’s agents’ balances, it was noted that the Company does not age its voluntary and involuntary automobile uncollected premiums in accordance with SSAP No. 6 of the NAIC Accounting Practices and Procedures Manual.

It is recommended that the Company age its uncollected premium balances in accordance with SSAP No. 6 of the NAIC Accounting Practices and Procedures Manual.

(iv) Deferred Tax Asset

Upon review of the Company's calculation for its deferred tax asset, it was noted the calculation was not in compliance with SSAP No. 10, Paragraph 10(b), which states in part the following:

> "Ten percent of statutory capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner adjusted to exclude any net DTA, EDP equipment and operating system software and any positive goodwill."

The calculation error did not cause a material misstatement of the Company's admitted asset; however, it is recommended that the Company use the DTA calculation as prescribed by SSAP No. 10 of the NAIC Accounting Practices and Procedures Manual.

(v) Unearned Premiums

Due to a system error, the Company's unearned premium reserve liability was miscalculated. The calculation error did not cause a material misstatement of the Company's liability; however, it is recommended that the Company verify its unearned premium reserve calculation to ensure accuracy when reporting its liabilities.

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2006 as determined by this examination and as reported by the Company:

Assets	Assets	Assets Not Admitted	Net Admitted Assets
Bonds	$39,299,250	$0	$39,299,250
Preferred stocks	2,627,978	0	2,627,978
Common stocks	1,719,896	0	1,719,896
Cash, cash equivalents and short-term investments	4,687,340	0	4,687,340
Investment income due and accrued	581,187	0	581,187
Uncollected premiums and agents' balances in the course of collection	1,270,218	127,034	1,143,184
Deferred premiums, agents' balances and installments booked but deferred and not yet due	4,576,521	0	4,576,521
Amounts recoverable from reinsurers	3,531,339	0	3,531,339
Current federal and foreign income tax recoverable and interest thereon	750,000	0	750,000
Net deferred tax asset	2,094,294	732,307	1,361,987
Electronic data processing equipment and software	166,699	0	166,699
Furniture and equipment, including health care delivery assets	122,629	122,629	0
Leasehold improvements	463,011	463,011	0
Other assets	80,130	48,129	32,001
Total assets	$61,970,492	$1,493,110	$60,477,382

Liabilities, surplus and other funds

Liabilities	Company
Losses	$19,866,478
Loss adjustment expenses	6,935,568
Commissions payable, contingent commissions and other similar charges	6,458
Other expenses (excluding taxes, licenses and fees)	242,619
Taxes, licenses and fees (excluding federal and foreign income taxes)	2,269,238
Unearned premiums	8,001,093
Ceded reinsurance premiums payable (net of ceding commissions)	7,165,962
Amounts withheld or retained by company for account of others	963,814
Payable for securities	17,953
Aggregate write-ins for liabilities	26,338
Total liabilities	$45,495,521
Surplus and Other Funds	
Common capital stock	$1,000,000
Gross paid in and contributed surplus	$709,200
Unassigned funds (surplus)	$13,272,661
Surplus as regards policyholders	$14,981,861
Total liabilities, surplus and other funds	$60,477,382

NOTE: The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2003 through 2006. 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. Underwriting and Investment Exhibit

Surplus as regards policyholders increased $10,439,514 during the four-year examination period January 1, 2003 through December 31, 2006, detailed as follows:

Statement of Income

Underwriting Income		
Premiums earned		$67,170,681
Deductions:		
Losses incurred	$33,771,985	
Loss adjustment expenses incurred	22,029,737	
Other underwriting expenses incurred	(2,130,259)	
Total underwriting deductions		53,671,463
Net underwriting gain		$13,499,218
Investment Income		
Net investment income earned	$4,100,545	
Net realized capital gain	98,101	
Net investment gain		4,198,646
Other Income		
Net gain or (loss) from agents' or premium balances charged off	$(529,574)	
Finance and service charges not included in premiums	1,440,596	
Aggregate write-ins for miscellaneous income	527	
Total other income		911,549
Net income before dividends to policyholders and before federal and foreign income taxes		$18,609,413
Dividends to policyholders		0
Net income after dividends to policyholders but before federal and foreign income taxes		$18,609,413
Federal and foreign income taxes incurred		7,596,282
Net income		$11,013,131

Capital and Surplus

	Gains in Surplus	Losses in Surplus	
Surplus as regards policyholders per report on examination as of December 31, 2002			$ 3,745,227
Net income	$11,013,131		
Net unrealized capital gains or (losses)		70,096	
Change in net deferred income tax	1,286,831		
Change in nonadmitted assets		805,452	
Dividends to stockholders		1,019,000	
Aggregate write-ins for gains and losses in surplus	831,220		
Total gains and losses	$13,131,182	$1,894,548	
Net increase (decrease) in surplus			$11,236,634
Surplus as regards policyholders per report on examination as of December 31, 2006			$14,981,861

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of $26,802,046 is the same as reported by the Company as of December 31, 2006. The examination analysis was conducted in accordance with generally accepted actuarial principles and was based on statistical information contained in the Company's internal records and in its filed annual statements.

The prior report on examination contained the following recommendations:

- It is recommended that management maintain complete internal records to support the paid and outstanding loss information reported in Schedule P of the Company's commercial automobile liability insurance line.

- It is recommended that the Company follow the Annual Statement Instructions by reporting complete and accurate claim count information in each of the required sections of Schedule P.

Based on a review of the Company's commercial automobile liability loss system, it was noted that there were discrepancies with the year-end loss reports provided by the Company to support its paid loss and Schedule P reporting, including errors relating to duplicate claim payments and missing paid loss amounts.

Additionally, there were discrepancies reported in Schedule P including negative paid loss amounts, missing claim count information and decreases in cumulative claim count numbers.

Therefore, it is again recommended that management maintain complete internal records to support the paid and outstanding loss information reported in Schedule P of the Company's commercial automobile liability insurance line.

Furthermore, it is again recommended that the Company follow the NAIC Annual Statement Instructions by reporting complete and accurate claim count information in each of the required sections of Schedule P.

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

ITEM			PAGE NO.
A.	Management		
	i.	It is recommended that the Company amend its by-laws to allow for attendance via conference call. The Company complied with this recommendation.	4
	ii.	It is recommended that the Company comply with the provisions of Section 1411(a) of the New York Insurance Law. The Company has not complied with this recommendation. A similar comment is made in this report.	5
	iii.	It is recommended that the Company comply with Article IV, Sections 4 and 7 of its by-laws by having its vice presidents and treasurer be full-time active members of the Company's executive management and fulfill their duties, as indicated in the Company's by-laws, as officers of the Company. The Company has not complied with this recommendation. A similar comment is made in this report.	6
	iv.	It is recommended that the Company's financial statements be sworn to by those principal officers that are fully knowledgeable with the corporate and financial affairs reported in the Company's filed financial statements. The Company complied with this recommendation.	6
	v.	It is again recommended that the Company cease disbursing funds to those individuals who are not providing either goods or service to the Company. It is further recommended that the Company comply with the provisions of Section 1217 of the New York Insurance Law. The Company is reminded of its fiduciary responsibility to protect the interest of Hereford's policyholders and of its obligation to disburse Company's funds in a prudent manner. The Company complied with this recommendation.	7

ITEM		PAGE NO.
vi.	It is recommended that the Company ensure that the officers and directors properly disclose all required information on their conflict of interest statements. The Company complied with this recommendation.	7
vii.	It is recommended that the Company obtain adequate fidelity bond coverage commensurate with its exposure. The Company has not complied with this recommendation. A similar comment is made in this report.	8
B.	Reinsurance	
i.	It is recommended that the Company amend its excess of loss reinsurance agreement to specify that any arbitration proceedings will be governed by New York Law and that any offsets are in accordance with Section 7427 of the New York Insurance Law. The Company complied with this recommendation.	11
ii.	It is recommended that prior to effecting new reinsurance agreement(s) or amendment(s) to existing agreements, the Company file such transactions with the Department for review pursuant to Section 1308(e)(1) of the New York Insurance Law. Subsequent to this examination, management complied with examiners' request by filing both workers' compensation and taxi liability quota share agreements with the Department for review. The Company complied with this recommendation.	12
C.	Holding Company System	
i.	It is recommended that the Company file annual holding company registration statements for all prior years under the current examination period as well as for the 2003 year pursuant to Part 80-1.4 of Department Regulation 52. The Company complied with this recommendation.	14
ii.	It is recommended that the Company fully comply with Department Regulation 52-A by filing in a timely manner its controlling producer report no later than April 1st of each year as required. The Company has not complied with this recommendation. A similar comment is made in this report.	15

ITEM		PAGE NO.
D	Accounts and Records	
	Cash Accounts	
i.	It is recommended that only full-time active employees of the Company be listed as signatories for the Company's bank accounts. All signatories should be approved by the Company's board of directors.	20
	The Company has not complied with this recommendation. A similar comment is made in this report.	
ii.	It is recommended that the Company implement proper segregation of duty regarding the Company's payroll, bank reconciliation and general ledger maintenance functions.	20
	The Company complied with this recommendation.	
iii.	It is recommended that management reconcile all bank accounts on a monthly basis in order to ensure greater internal control over Company cash accounts.	20
	The Company complied with this recommendation.	
iv.	It is recommended that management include more than one authorized signatory to each Company bank account.	20
	The Company complied with this recommendation.	
v.	It is recommended that long-standing open checks be researched and cancelled or re-issued, if necessary.	20
	The Company complied with this recommendation.	
	Investment Accounts	
i.	It is recommended that the Company file all newly acquired investments for security rating with the NAIC SVO.	21
	The NAIC no longer requires insurers to file newly acquired investments for security rating; therefore, this recommendation is no longer applicable.	
ii.	It is also recommended that the Company verify and ensure the validity of the investment information contained in the Company's signed NAIC SVO Compliance Certification filing.	21
	The NAIC no longer requires insurers to file SVO Compliance	

ITEM		PAGE NO.
	Certifications; therefore, this recommendation is no longer applicable.	
iii.	It is recommended that the Company implement a separate custodial agreement with North Fork Bank ("NFB") applicable to Company investments both managed and held by NFB pursuant to the parties' investment management agreement.	21
	The Company has not complied with this recommendation. A similar comment is made in this report.	
iv.	It is recommended that management establish formal written investment guidelines. Management should further provide any investment manager of the Company with the guidelines to be followed by the managers in their decision making and administration of the Company's investment functions.	21
	The Company complied with this recommendation.	
v.	It is recommended that the Company amend its existing custodial agreement to incorporate the standard protective clauses prescribed by the NAIC and also acknowledged by the Department as good public policy.	21
	The Company has not complied with this recommendation. A similar comment is made in this report.	
	Allocation of Expenses	
i.	It is recommended that management comply with Sections 105.5 and 105.16 of Department Regulation 30 by reporting expenses in the proper expense accounts.	22
	The Company complied with this recommendation.	
ii.	It is recommended that management comply with Section 107.4 of Department Regulation 30 by allocating all ceding reinsurance commissions to other underwriting expenses in the Company's filed annual statements.	22
	The Company complied with this recommendation.	

ITEM		PAGE NO.
	Record Retention	
i.	It is recommended that management update its year-end record retention procedures to include electronic files in addition to the Company's hardcopy files.	23
	The Company complied with this recommendation.	
ii.	It is recommended that management refrain from its current practice of maintaining the Company's back-up workers' compensation electronic data file off-site at the home of a staff employee. Instead, management should establish a more reliable back-up procedure such as an alternative back-up of Company files at an alternative off-site facility.	23
	The Company complied with this recommendation.	
	Certified Public Accountant ("CPA")	
	It is again recommended that management comply with Section 307(b)(1) of the New York Insurance Law.	24
	The Company complied with this recommendation.	
E.	Losses and loss adjustment expenses	
i.	It is recommended that management maintain complete internal records to support the paid and outstanding loss information reported in Schedule P of the Company's workers' compensation insurance and commercial automobile lines.	29
	The Company has not complied with this recommendation. A similar comment is made in this report.	
ii.	It is again recommended that the Company follow the NAIC Annual Statement Instructions by reporting in Schedule P amounts received and anticipated for salvage and subrogation.	29
	The Company complied with this recommendation.	
iii.	It is recommended that the Company follow the NAIC Annual Statement Instructions by reporting complete and accurate claim count information in each of the required sections in Schedule P.	29
	The Company has not complied with this recommendation. A similar comment is made in this report.	

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM		PAGE NO.
A.	Management	
i.	It is recommended that the Company record any investment approval in its committee minutes pursuant to Section 1411(a) of the New York Insurance Law. A similar recommendation was made in the prior report on examination.	4
ii.	It is again recommended that the Company comply with Article IV, Sections 4 and 7 of its by-laws by having its vice presidents be full-time active members of the Company's executive management and fulfill their duties, as indicated in the Company's by-laws, as officers of the Company.	5
iii.	It is again recommended that the Company obtain adequate fidelity bond coverage commensurate with its exposure.	5
B.	Reinsurance	
i.	It is recommended that the Company properly account for its NYAIP participation in accordance with SSAP No. 63, paragraph 8 of the NAIC Accounting Practices and Procedures Manual.	7
ii.	It is recommended that the Company amend its workers' compensation second and third layer excess of loss and per policy excess of loss agreements to include all of the required language pursuant to SSAP No. 62, paragraph 8 of the NAIC Accounting Practices and Procedures Manual.	8
Iii	It is recommended that the Company amend its taxi liability quota share reinsurance agreement to include all terms and conditions agreed upon by both parties pursuant to Department Circular Letter No. 8 (2005).	9
C.	Holding Company System	
i.	It is again recommended that the Company fully comply with Department Regulation 52-A by filing in a timely manner its controlling producer report no later than April 1st of each year as required.	10
ii.	It is recommended that the Company file its lease agreement with the Department in accordance with Section 1505(d) of the New York Insurance Law.	12

ITEM		PAGE NO.
D	Accounts and Records	
i.	Cash On Hand	
	It is recommended that the company comply with Section 1411(b) of the New York Insurance Law and restrict its signatory access to the company's bank accounts to employees.	13
ii.	Investment Accounts	
a.	It is again recommended that the Company amend its existing custodial agreement to incorporate the standard protective clauses prescribed by the NAIC Examiners Financial Condition Handbook and also acknowledged by the Department as good public policy.	14
b.	It is again recommended that that the Company implement a separate custodial agreement with Capital One Bank applicable to the Company's investments both managed and held by Capital One Bank pursuant to the parties' investment management agreement.	14
iii.	Agents' Balances	
	It is recommended that the Company age its uncollected premium balances in accordance with SSAP No. 6 of the NAIC Accounting Practices and Procedures Manual.	14
iv.	Deferred Tax Asset	
	It is recommended that the Company use the DTA calculation as prescribed by SSAP No. 10 of the NAIC Accounting Practices and Procedures Manual.	15
v.	Unearned Premium	
	It is recommended that the Company verify its unearned premium reserve calculation to ensure accuracy when reporting its liabilities.	15
E.	Losses and loss adjustment expenses	
i.	It is again recommended that management maintain complete internal records to support the paid and outstanding loss information reported in Schedule P of the Company's commercial automobile insurance line.	20
ii.	It is again recommended that the Company follow the NAIC Annual Statement Instructions by reporting complete and accurate claim count information in each of the required sections in Schedule P.	20

Respectfully submitted,

/s/
Dilbrina Belgrave
Senior Insurance Examiner

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

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

/s/
Dilbrina Belgrave

Subscribed and sworn to before me

this__________ day of ___________________, 2009.

Appointment No. 22653

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:*

Dilbrina Belgrave

as proper person to examine into the affairs of the

HEREFORD 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* June, *2007*

ERIC R. DINALLO
Superintendent of Insurance