REPORT ON EXAMINATION

OF THE

HEREFORD INSURANCE COMPANY

AS OF

DECEMBER 31, 2012

DATE OF REPORT	MARCH 25, 2014
EXAMINER	MOSES EGBON

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March 25, 2014

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 30901 dated December 14, 2012, attached hereto, I have made an examination into the condition and affairs of Hereford Insurance Company as of December 31, 2012, and submit the following report thereon.

Wherever the designation "the Company" appears herein without qualification, it 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 State Department of Financial Services.

The examination was conducted at the Company's home office located at 36-01 43rd Avenue, Long Island City, New York, 11101.

1. SCOPE OF EXAMINATION

The Department has performed an examination of Hereford Insurance Company, a single-state insurer. The previous examination was conducted as of December 31, 2006. This examination covered the six-year period from January 1, 2007 through December 31, 2012. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

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

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process. This examination also included a review and evaluation of the Company's own control environment assessment. The examiners also relied upon audit work performed by the Company's independent public accountants when appropriate.

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

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

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

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

2. DESCRIPTION OF COMPANY

Hereford Insurance Company was incorporated under the laws of the State of New York on October 5, 1982. It became licensed on April 1, 1986 and commenced business on the same date.

Capital paid in is $1,000,000 consisting of 1,000,000 shares of $1 par value per share common stock. Gross paid in and contributed surplus is $709,200 and has remained the same since the previous 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 seven nor more than twenty members. The board met annually during each calendar year. At December 31, 2012, the board of directors was comprised of the following eleven members:

Name and Residence	Principal Business Affiliation
Vincent Bitet Smithtown, NY	President, Bitet Insurance Brokerage
Richard Chin Wantagh, NY	Chief Operating Officer, Pearland Brokerage
Keith Greenbaum New York, NY	Senior Vice President, Hereford Insurance Company
Neil Greenbaum New York, NY	President and Secretary, Hereford Insurance Company President, Drivers Insurance Company
Pearl Greenbaum Boyton, Beach, FL	Retired Treasurer, Hereford Insurance Company

Name and Residence	Principal Business Affiliation
Eugene Haber Roslyn, NY	Partner, Colbert, Haber & Haber
Barbara Hamill W. Hartford, CT	Vice President, Hereford Insurance Company
John Hamill, W. Hartford, 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
Annie Weinstein New York, NY	Senior Vice President and 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 and each board member had an acceptable record of attendance.

As of December 31, 2012, the principal officers of the Company were as follows:

Name	Title
Neil Greenbaum	President & Secretary
Keith Greenbaum	Senior Vice President & Treasurer
Annie Vera Weinstein	Senior Vice President

B. Territory and Plan of Operation

As of December 31, 2012, the Company was licensed to write business in New York only.

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

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 $1,800,000.

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

Calendar Year	Direct Premiums Written
2007	$82,582,961
2008	$85,354,077
2009	$75,329,866
2010	$74,149,530
2011	$88,320,825
2012	$94,474,260

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

Effective January 1, 2010, the Company entered into an agreement with the New York Independent Livery Drivers Benefit Fund, Inc. (ILDBF), to write the workers' compensation insurance for the ILDBF on behalf for all qualified independent livery drivers who are members of the ILDBF. The ILDBF is a non-profit corporation created by Chapter 392 and described by Article 6-G of the Workers' Compensation Laws of New York, to provide workers' compensation benefits in limited situations to independent livery drivers dispatched by members of the ILDBF.

The Company writes workers' compensation premiums of about $5,000,000 annually from the ILDBF. It provides workers' compensation benefits for serious injuries and crimes committed against drivers dispatched by qualifying independent livery bases in New York City, Westchester and Nassau.

C. Reinsurance

Assumed Reinsurance

The Company does not assume reinsurance.

Ceded Reinsurance

The Company has structured its ceded reinsurance program as follows:

Type of Contract	Cession
Workers' Compensation:	
Quota Share	40% of $125,000 per occurrence any loss or losses.
First Excess of Loss	$1,175,000 excess of $125,000 ultimate net loss, each and every occurrence.
Second Excess of Loss	$4,700,000 excess of $1,300,000 ultimate net loss, any one occurrence.
Third Excess of Loss	$4,000,000 excess of $6,000,000 ultimate net loss, any one occurrence.
Commercial Automobile Liability:	
Taxi Liability Quota Share	Section A: 35% quota share covering NY taxis including Ambulettes, Medallions, Black Cars, Silver Cars, Luxury Cars, Car Services and Suburban Car Services. Section B: 35% quota share covering Assigned Risk Business written under AIPSO and in respect of up to a maximum of 10 Special NY Livery units. Section C: 35% quota share covering Ambulette business.
Per Policy Excess of Loss Three layers	1. $200,000 excess of $300,000 per risk covering business written under AIPSO and in respect of up to a maximum of 10 NY Livery units and of up a maximum of 500 units classified as Luxury Limousines. Nevertheless, the first $75,000 of losses otherwise recoverable shall be retained by the reinsured for their own account. 2. $500,000 excess of $500,000 per risk covering "Yellow Medallion Taxi", "Black Car", "Silver Car" and "Car Service", Ambulette, Private Passenger Auto, business accepted under AIPSO, and up to a maximum of 500 units classified as Luxury Limousines.

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3. $1,000,000 excess of $1,000,000 per risk covering "Yellow Medallion Taxi", "Black Car", "Silver Car" and "Car Service", Ambulette, Private Passenger Auto, business accepted under AIPSO, and up to a maximum of 500 units classified as Luxury Limousines.

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

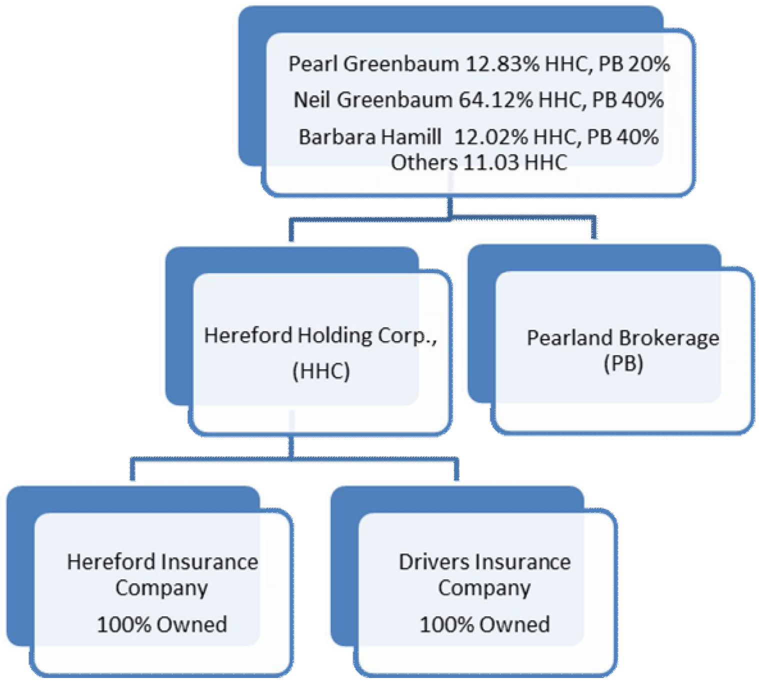
Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62R. Representations were supported by 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. 62R.

D. Holding Company System

The Company is a wholly-owned subsidiary of Hereford Holding Company Inc. ("HHC"), a non-operating New York holding company, 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 64.12% of HHC stock. Mr. Greenbaum also holds 40% interest in Pearland Brokerage, which is the Company's primary producer. In addition, according to Mr. Greenbaum in 1995, he formed All Taxi Management, a company that manages taxi medallions for owners and leases taxis to drivers. All of Mr. Greenbaum's businesses are operated at the same Long Island City location as Hereford Insurance Company.

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 pursuant to Article 15 of the New York Insurance Law and Department Regulation 52. Additionally, the Company's controlling producer reports were filed in a timely manner pursuant to Part 80-2.2 of Department Regulation 52-A.

The following is a chart of the holding company system at December 31, 2012:



At December 31, 2012, 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, 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, 2007, the Company entered into a lease agreement with Thirty Six O One, LLC, which is 100% owned by the Greenbaum and Hamill families. Under the agreement, the Company agreed to rent the entire second floor, and 9500 square feet of the third floor and allocated car parking spaces located at 36-01 43rd Avenue, Long Island City, New York, for ten years. This agreement was filed with this Department, pursuant to Section 1505 of the New York Insurance Law.

Management Agreement

Effective November 1, 2011, the Company entered into a management agreement with Drivers Insurance Company. This agreement directs Hereford to provide the Drivers Insurance Company with advice, staff, supervision, and managerial assistance. This agreement was filed with this Department pursuant to Section 1505 of the New York Insurance Law.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2012, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	1,411%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	116%
Premiums in course of collection to surplus as regards policyholders	64%

All of the above ratios are above the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners. The ratios have been recalculated to incorporate the examination increase to the liability for Losses and loss adjustment expenses, and corresponding decrease in Surplus as regards policyholders.

The underwriting ratios presented below are on an earned/incurred basis and encompass the 6-year period covered by this examination:

	Amounts	Ratios
Losses and loss adjustment expenses incurred	$234,320,975	97.58%
Other underwriting expenses incurred	22,694,111	9.45
Net underwriting loss	(16,880,691)	(7.03)
Premiums earned	$240,134,395	100.00%

F. Accounts, Records and Internal Controls

Agents' Balances

The Company maintains an aging report of its premiums receivables/agents' balances related only to its workers' compensation business. An aging report is a critical management tool with both analytical and valuation features that help determine current and overdue account balances. Uncollected premium balances that become over ninety days due are required to be reported as non-admitted assets in accordance to NAIC SSAP No. 6. It is recommended that the Company create and implement an aging report that would include all of its uncollected premium balances and not just the ones that are related to its workers' compensation business.

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2012, as determined by this examination and as reported by the Company:

Assets	Assets	Assets Not Admitted	Net Admitted Assets
Bonds	$ 79,347,776		$ 79,347,776
Preferred stocks	85,520		85,520
Common stocks	1,104,060		1,104,060
Cash, cash equivalents and short-term investments	16,823,248		16,823,248
Receivables for securities	53,244		53,244
Investment income due and accrued	990,380		990,380
Uncollected premiums and agents' balances in the course of collection	2,611,665		2,611,665
Deferred premiums, agents' balances and installments booked but deferred and not yet due	5,908,000	$ 329,000	5,579,000
Amounts recoverable from reinsurers	14,209,046		14,209,046
Current federal and foreign income tax recoverable and interest thereon	21,877		21,877
Net deferred tax asset	3,372,000	979,000	2,393,000
Electronic data processing equipment and software	189,836	189,836	
Furniture and equipment, including health care delivery assets	23,913	23,913	
Aggregate write-ins for other than invested assets	1,241,573	561,688	679,885
Totals	$125,982,138	$2,083,437	$123,898,701

Liabilities, Surplus and other funds	Examination	Company	Surplus Increase (Decrease)
Losses and loss adjustment expenses	$ 87,637,878	$ 67,587,878	$20,050,000
Commissions payable, contingent commissions and other similar charges	39,609	39,609	
Other expenses (excluding taxes, licenses and fees)	1,029,861	1,029,861	
Taxes, licenses and fees (excluding federal and foreign income taxes)	57,429	57,429	
Unearned premiums	15,958,629	15,958,629	
Advance premium	1,479,845	1,479,845	
Ceded reinsurance premiums payable (net of ceding commissions)	12,309,192	12,309,192	
Amounts withheld or retained by company for account of others	1,230,983	1,230,983	
Payable for securities	33,617	33,617	
Aggregate write-ins for liabilities	39,603	39,603	0
Total liabilities	$119,816,646	$ 99,766,646	$20,050,000
Common capital stock	$ 1,000,000	$1,000,000	
Gross paid in and contributed surplus	709,200	709,200	
Unassigned funds (surplus)	2,372,855	22,422,855	$20,050,000
Surplus as regards policyholders	4,082,055	24,132,055	$20,050,000
Totals	$123,898,701	$123,898,701	

Note: The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2007 through 2012. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Statement of Income

Surplus as regards policyholders decreased $10,899,806 during the 6-year examination period January 1, 2007 through December 31, 2012, detailed as follows:

Underwriting Income		
Premiums earned		$240,134,395
Deductions:		
Losses and loss adjustment expenses incurred	$234,320,975	
Other underwriting expenses incurred	22,694,111	
Aggregate write-ins for underwriting deductions	0	
Total underwriting deductions		257,015,086
Net underwriting loss		$(16,880,691)
Investment Income		
Net investment income earned	$ 13,220,351	
Net realized capital loss	(982,113)	
Net investment gain		12,238,238
Other Income		
Net loss from agents' or premium balances charged off	$ (709,738)	
Finance and service charges not included in premiums	3,011,542	
Aggregate write-ins for miscellaneous income	1,193,990	
Total other income		3,495,794
Net loss before dividends to policyholders and before federal and foreign income taxes		$(1,146,659)
Dividends to policyholders		0
Net loss after dividends to policyholders but before federal and foreign income taxes		$(1,146,659)
Federal and foreign income taxes incurred		5,904,683
Net Loss		$(7,051,342)

	Gains in Surplus	Losses in Surplus	
Surplus as regards policyholders per report on examination as of December 31, 2006			$14,981,861
Net loss		$ 7,051,342	
Net unrealized capital gains	$ 9,156		
Change in net deferred income tax	1,277,707		
Change in non-admitted assets		590,327	
Dividends to stockholders	0	4,545,000	
Net decrease in surplus	$1,286,863	$12,186,669	$(10,899,806)
Surplus as regards policyholders per report on examination as of December 31, 2012			$ 4,082,055

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of $87,637,878 is $20,050,000 more than the $67,587,878 reported by the Company in its December 31, 2012, filed annual statement. The examination analysis of the Loss and loss adjustment expense reserves was conducted in accordance with generally accepted actuarial principles and statutory accounting principles, including the NAIC Accounting Practices & Procedures Manual, Statement of Statutory Accounting Principle No. 55 (“SSAP No. 55”).

The examination change is the result of the analysis of the Company’s Loss and loss adjustment expense reserves conducted by the Department’s actuaries. The data underlying our analysis was derived from statistical information contained in the Company’s internal records and its filed annual statements. Based on our analysis, we project that the Company’s carried Loss and Defense and Cost Containment (“DCC”) expense reserves were deficient by $6.3 million (on carried reserves of $62.4 million) and its Adjusting and Other (“A&O”) expense reserves were deficient by $13.75 million (on carried reserves of $5.2 million).

By virtue of its one-year adverse runoff for accident years 2012 and prior, as reported by the Company in its filed annual statement as of December 31, 2013, we note that the Company recognized $10.4 million of the Department’s $20.0 million projected Loss and loss adjustment expense reserve deficiency, $1.8 million of which was attributable to Losses and DCC expenses, and $8.6 million was attributable to A&O expenses.

Upon review of the Company's loss adjustment expenses, it was noted that the Company had classified its in-house legal department defense expenses as A&O expenses for calendar years 2006 through 2012. Pursuant to SSAP No. 55, defense and litigation expenses, whether internal or external, should be classified as DCC expenses. At our request, the Company prepared revised paid and incurred triangles to categorize these expenses as DCC; however, when the Company did the reclassification, it took the general claims department overhead expenses, which should have been classified as A&O, and also reclassified them as DCC. The Department did not pursue having the general claims department overhead expenses reclassified back to A&O for purposes of our analysis due to immateriality; however, these expenses should be classified as A&O expenses in future annual statements.

It is recommended that the Company correctly classify its in-house legal department defense expenses as DCC and its general claims department overhead expenses as A&O, pursuant to the provisions of SSAP No. 55.

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

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.	4
	The Company has complied with this recommendation.	
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
	The Company has complied with this recommendation.	
iii.	It is again recommended that the Company obtain adequate fidelity bond coverage commensurate with its exposure.	5
	The Company has complied with this recommendation.	
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
	The Company has complied with this recommendation.	
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
	The Company has complied with this recommendation.	
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
	The Company has complied with this recommendation.	

ITEM		PAGE NO.
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. The Company has complied with this recommendation.	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. The Company has complied with this recommendation.	12
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. The Company has complied with this recommendation.	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. The Company has complied with this recommendation.	14
b.	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. The Company has complied with this recommendation.	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. The Company has not complied with this recommendation. A similar comment is made in this report.	14

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM		PAGE NO.
A.	Accounts, Records and Internal Controls	
	Agents' Balance	
	It is recommended that the Company create and implement an aging report that would include all of its uncollected premium balances and not just the ones that are related to its workers' compensation business.	10
B.	Classification of Loss Adjustment Expenses	
	It is recommended that the Company correctly classify its in-house legal department defense expenses as DCC and its general claims department overhead expenses as A&O, pursuant to the provisions of SSAP No. 55.	15

Respectfully submitted,

_____________/s/___________
Moses Egbon, CFE
Associate Insurance Examiner

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

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

_____________/s/___________
Moses Egbon

Subscribed and sworn to before me

this__________ day of ___________________, 2014.

APPOINTMENT NO. <u>*30901*</u>

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:*

Moses Egbon

as a proper person to examine the affairs of the

HEREFORD INSURANCE COMPANY

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

COMPANY

with such other information as he shall deem requisite.

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

this 14th day of December, 2012

BENJAMIN M. LAWSKY
Superintendent of Financial Services

By:

Jean Marie Cho
Deputy Superintendent