

REPORT ON EXAMINATION

OF THE

UTICA MUTUAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2004

DATE OF REPORT

AUGUST 8, 2007

EXAMINER

ALFRED W. BLOOMER, JR.

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

August 8, 2006

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 22354 dated April 1, 2005, attached hereto, I have made an examination into the condition and affairs of Utica Mutual Insurance Company as of December 31, 2004, and submit the following report thereon.

Wherever the designations "the Company" or "UMIC" appear herein without qualification, they should be understood to indicate Utica Mutual 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 offices located at 180 Genesee Street, New Hartford, New York, 13413.

## 1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1999. This examination covered the five-year period from January 1, 2000 through December 31, 2004. 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, 2004, 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.

Concurrent examinations were conducted of Graphic Arts Mutual Insurance Company ("GAMIC"), a New York domiciled insurer, and of Utica National Assurance Company ("UNAC"), a New York domiciled Insurer, as of December 31, 2004. These companies are part of a pooling operation with UMIC, as further described in this report in Item 2C, "Reinsurance". Separate reports on examination have been rendered relative to Graphic Arts Mutual Insurance Company and Utica National Assurance Company.

Concurrent examinations have also been conducted of Republic-Franklin Insurance Company (“RFIC”), an Ohio domestic insurer, by the Ohio Insurance Department and of Utica National Insurance Company of Texas (“UNIT”), a Texas domestic insurer, by the Texas Insurance Department. RFIC has been a party to the aforementioned pooling agreement since January 1, 1984 and UNIT has been a party since January 1, 1995.

## **2. DESCRIPTION OF COMPANY**

Utica Mutual Insurance Company was incorporated under the laws of the State of New York on February 13, 1914 as the “Utica Mutual Compensation Insurance Corporation.” It became licensed on June 1, 1914 and commenced business on July 1, 1914. The present name was adopted on February 1, 1919.

In 1967, the Company entered into an agreement with Graphic Arts Mutual Insurance Company providing for common management of the two companies. Since 1969, the Company has pooled premiums, losses and expenses with GAMIC through a reinsurance pooling agreement which is discussed in greater detail in this report in Item 2C, “Reinsurance.”

In January 1983, the Company purchased most of the outstanding shares of Republic-Franklin Insurance Company, a stock property and casualty company organized under provisions of the Ohio Insurance Law. UMIC subsequently sold 6% of its interest in RFIC to GAMIC, creating a 94% and 6% ownership. In 1984, RFIC was admitted to the common management and pooling agreement between UMIC and GAMIC. Furthermore, in 1995 UMIC acquired all the outstanding capital stock of Utica National Insurance Company of Texas which was then admitted to the aforementioned common management and pooling agreement between UMIC and GAMIC. Also, in 1995, the Company acquired all of the common stock of Graphic Arts Insurance Company. This company changed its corporate title to Utica National Assurance Company (“UNAC”) and was admitted to the common management and pooling agreement in 1997. As of December 31, 2004, the pooling agreement resulted in sharing of premium income, losses and expenses as follows:

Utica Mutual Insurance Company	89%
Graphic Arts Mutual Insurance Company	5%
Republic-Franklin Insurance Company	3%
Utica National Assurance Company	2%
Utica National Insurance Company of Texas	1%

Under the present agreement, all transactions and items related to the insurance and/or general operations of the companies are pooled. The only major items that remain exempt are those related to investments and inter-company accounts.

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 thirty-one members. The board meets four times during each calendar year. At December 31, 2004, the board of directors was comprised of the following eighteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Russell A. Acevedo, MD Fayetteville, NY	Director, Critical Care Associates
Clarence W. Bachman Penfield, NY	President, Empire Digital Communications
Alfred E. Calligaris Watertown, NY	President, Chairman of the Board and Chief Executive Officer Stebbins Engineering & Manufacturing Company
Roy A. Cardia Tappan, NY	Retired
Paul A. Hagstrom, Ph.D Clinton, NY	Associate Professor of Economics, Hamilton College
Gregory M. Harden McConnellsville, NY	President and Chief Executive Officer, Harden Furniture Company
Jerry J. Hartman York, PA	President, Reese Press
William C. Heston Savannah, GA	Chairman of the Board, Utica National Insurance Group
Zelda J. Holcomb, Ph.D Columbia, MD	Operations Vice-President, Edison Schools Inc.
Herbert P. Ladds, Jr. Buffalo, NY	Chairman of the Board, Columbus McKinnon Corporation
Brian P. Lytwynec Ilion, NY	Executive Vice-President, Utica National Insurance Group

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Nicholas O. Matt New Hartford, NY	President, F.X. Matt Brewing Company
Anthony C. Paolozzi Whitesboro, NY	Executive Vice-President, Treasurer and Chief Financial Officer, Utica National Insurance Group
Alan J. Pope, Sr. Gainsville, GA	President and Chief Executive Officer, Love, Douglas and Pope
Timothy R. Reed Utica, NY	President, ECR International
James D. Robinson New Hartford, NY	President and Chief Executive Officer, Utica National Insurance Group
Linda E. Romano New Hartford, NY	Attorney-at-law, Bond, Schoeneck and King
John R. Zapisek Utica, NY	Retired

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 has an acceptable record of attendance.

Section 1209(b) of the New York Insurance Law states:

“(b) Such corporation shall have not less than thirteen directors . . . and such officers as shall be provided for in its charter or by-laws. *The directors . . . shall be elected at the annual meetings of the members, and all except four of the directors of such corporation, elected after the organization of the corporation is completed and it has been licensed to issue insurance policies, must be members of the corporation or officers of member corporations*” (emphasis added.)

Review of the insurance policies issued by the Utica Mutual Insurance Company to the directors and member corporations for which the directors are officers, revealed that as of the examination date, five directors are neither members of the Corporation nor officers of member corporations. That exceeds the allowable number of non member directors permitted by the aforementioned section of law.

It is recommended that the Company comply with Section 1209(b) of the New York Insurance Law by reducing to no more than four, the number directors who are neither members of the corporation nor officers of member corporations.

In accordance with the by-laws approved by this Department, the executive committee is authorized to act on behalf of the board of directors. Review of the executive committee minutes does not indicate that the minutes of the previous meeting were reviewed and approved by the committee. Review of the board of directors' minutes also does not indicate that the executive committee minutes were reviewed and the actions of that committee ratified by the board.

In response to the examination, the Company replied that the full board is:

“provided a copy of the minutes of each executive committee meeting and at each of the board’s meeting, the actions of the executive committee taken between meetings of the full board are ratified” and that “a ‘Draft’ of the proposed minutes is provided to the chair of the executive committee meeting for review and approval. The minutes of the meeting are not finalized until the Chair approves such Draft minutes.”

While these may be the procedures taken, the Company could not substantiate that these actions have taken place.

Further, review of the board of directors' minutes does not indicate that the board has received and reviewed these minutes. The board does ratify the actions of the committee; it does not ratify the correctness and accuracy of the minutes.

It is recommended that the executive committee review and ratify the minutes of the prior meeting and correct any misinterpretations of the events or actions of the committee at that meeting as reported in the minutes.

The corporate by-laws require three persons to be appointed to receive the proxies of members at the annual meeting of policyholders. During the period under examination, the nominating committee nominated and the executive committee elected only two persons to accept the proxies of the members of the Company.

It is recommended that the nominating and executive committees comply with the approved by-laws of the company and appoint three members to receive and vote the proxies of the Corporation members at the annual meeting of policyholders.

As of December 31, 2004, the principal officers of the Company were as follows:



<u>Name</u>	<u>Title</u>
James D. Robinson	President and Chief Executive Officer
George P. Wardley, III	Secretary
Anthony C. Paolozzi	Executive Vice-President, Chief Financial Officer and Treasurer
Brian P. Lytwynec	Executive Vice-President

On February 27, 2006, subsequent to the examination date, the board of directors appointed Brian P. Lytwynec to the office of president and chief operating officer of the Company.

B. Territory and Plan of Operation

As of December 31, 2004, the Company was licensed to write business in all fifty states, the District of Columbia and Puerto Rico and by the Government of Canada in all provinces except the Yukon Territory.

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
15	Worker's compensation and employer's liability
16	Fidelity and surety
17	Credit
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity
24	Credit unemployment
26	Gap
27	Prize indemnification
28	Service Contract reimbursement
29	Legal services

The Company is also licensed to transact such workers' compensation insurance as may be incident to coverages contemplated under paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law including insurance described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No 804, 69<sup>th</sup> Congress as amended; 33USC Section 901 et seq. as amended).

Based on the lines of business for which the Company is licensed 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 \$9,100,000.

The Company obtains its business through a network of 1069 agents and brokers as of the examination date. The Company's agency plant consists primarily of "neighborhood" agents and brokers. The Company does not solicit business through the national brokerage firms. During the examination period, the Company decreased its agency plant by approximately 25%. This was done to upgrade the quality of the placements it was accepting and to eliminate the cost of servicing agencies that were consistently producing sub-standard business. This decrease of producers continued in 2005.

Additionally, the Company participates in various mandatory pools, associations, syndicates and FAIR plans throughout the United States. The Company is not currently participating in voluntary pools but does have residual losses from its participation in the Mutual Marine Office pool.

Although the Company operates in all fifty states, their focus is on sixteen states. They write personal lines in New York, Massachusetts, Connecticut, Virginia, North Carolina, and Tennessee only. In all other states the Company offers a full array of commercial products. It should be noted that New York, Massachusetts and New Jersey represent over 54% of the Company's direct written premium.

The bulk of the Company's business is commercial lines. Four lines of business, other liability, workers' compensation, commercial auto liability and commercial multi-peril represent approximately 76% of the Company's direct writings.

The Company assumes 100% of all insurance written by its wholly-owned subsidiary, Utica Specialty Risk Insurance Company, and Utica Lloyds of Texas.

The Company maintains seven full service branch offices and three district claims offices.

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

<u>Calendar Year</u>	<u>New York State</u>	<u>Total United States</u>	<u>Premiums Written in New York State as a percentage of United States Premium</u>
2000	\$81,522,696	\$287,697,744	28.34%
2001	\$96,321,561	\$295,913,733	32.55%
2002	\$113,406,157	\$315,097,336	35.99%
2003	\$121,402,402	\$328,345,441	36.97%
2004	\$113,691,472	\$314,978,314	36.10%

### C. Reinsurance

Assumed reinsurance accounted for 54.55% of the Company's gross premium written at December 31, 2004. During the period covered by this examination, the Company's assumed reinsurance business has decreased. The main reason for the decrease was that the Company implemented stricter underwriting standards and reduced its participation in voluntary pools. The major portion of assumed reinsurance represents business obtained through a pooling agreement with four affiliates. Additionally, the Company's participation in various mandated pools is reflected in its assumed reinsurance activity. At the examination date, the Company is assuming no new business from voluntary pools and associations.

The Company utilizes reinsurance accounting as defined in the NAIC Accounting Practices & Procedures Manual Statement of Statutory Accounting Principle ("SSAP") No. 62 for all of its assumed reinsurance business.

Utica Mutual Insurance Company participates in an inter-company pool with four other property casualty affiliates. Under this pooling agreement, premiums, losses and expenses are shared as follows: Utica Mutual Insurance Company (89%), Graphic Arts Mutual Insurance Company (5%), Republic-Franklin Insurance Company (3%), Utica National Assurance Company (2%), and Utica National Insurance Company of Texas (1%). The business written by Utica Lloyds of Texas and Utica Specialty Insurance Company is ceded 100% to Utica Mutual and is shared with the pool members in accordance with the above-mentioned pooling agreement.

The review of the inter-company pooling agreement indicates that certain accounts were either not pooled or were not pooled in accordance with the agreement. The agreement calls for the following accounts to be pooled, that were either not pooled or not pooled in accordance with the pooling agreement in the Company's filed annual statement:

- Uncollected premiums and agents' balances in the course of collection
- Accounts receivable – Policy Deductible
- Ceded reinsurance premiums payable
- Pension benefit obligations
- Loss adjustment expenses incurred
- Other underwriting expenses incurred
- Total underwriting deductions
- Finance and service charge not included in premium

The total amount of the unpooled or incorrectly pooled items is not material to the Company's surplus and therefore, no adjustment will be made.

It is recommended that the Company comply with the terms of its inter-company pooling agreement and pool all accounts in accordance with that agreement.

The Company has established standards by which its Reinsurance Department is not permitted to place reinsurance with reinsurers that do not comply with those standards. The Company requires that all domestic reinsurers have a minimum of an A.M. Best rating of A- or better and a minimum of \$50,000,000 in policyholders' surplus and that foreign reinsurers have a minimum rating of BBB from Standard and Poor and a minimum of \$50,000,000 in policyholders' surplus. All reinsurers with a non-insurance parent having a controlling interest are generally not acceptable. Variances from these guidelines require approval from the Reinsurance Security Committee.

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

<u>Type of Treaty</u>	<u>Cession</u>
<u>Property</u>	
1 <sup>st</sup> layer 100% Authorized	\$9,000,000 excess of \$1,000,000 each risk, each loss. Subject to a loss occurrence limit of \$18,000,000; agreement is subject to an annual aggregate deductible of \$5,000,000.
2 <sup>nd</sup> layer 100% Authorized	
<u>Casualty (6 layers)</u>	
1 <sup>st</sup> layer 95% Authorized	\$99,000,000 excess of \$1,000,000 each and every loss; annual aggregate deductible of \$4,500,000.
2 <sup>nd</sup> layer 72.5% Authorized	
3 <sup>rd</sup> layer 75% Authorized	
4 <sup>th</sup> layer 69.25% Authorized	
5 <sup>th</sup> layer 98.01% Authorized	
6 <sup>th</sup> layer 93.13% Authorized	
<u>Agents' Errors &amp; Omissions</u>	
1 <sup>st</sup> layer 95% Authorized	\$4,000,000 excess of \$1,000,000 per policy per claim, \$5,000,000 excess of \$5,000,000 per policy per claim.
2 <sup>nd</sup> layer 93.39% Authorized	

<u>Type of Treaty</u>	<u>Cession</u>
<u>Surety</u> 100% Authorized	\$3,000,000 excess of \$1,000,000, any one principal.
<u>Boiler and Machinery</u> 100% Authorized	100% of \$100,000,000 of equipment breakdown liability.
<u>Automatic Umbrella</u> 100% Authorized	90% of \$1,000,000 and 100% of \$9,000,000 excess of \$1,000,000 of the liability produced by Graphic Arts Industries.
<u>Errors &amp; Omissions</u> 100% Authorized	50% of \$1,000,000 each occurrence of the liability produced by graphic arts industries.
<u>Property and Casualty</u> 100% Authorized	100% of the liability for the business produced by the Kansas Farm Bureau.
<u>Personal Umbrella</u> 100% Authorized	75% of \$1,000,000, each occurrence; \$4,000,000 excess of \$1,000,000, each occurrence.
<u>Commercial Umbrella</u> 100% Authorized	50% of \$5,000,000 each occurrence; \$5,000,000 excess of \$5,000,000, each occurrence.  <u>For contractor business only:</u> 50% of \$1,000,000 each occurrence for contractor business; 100% of \$9,000,000 excess of \$1,000,000.
<u>School Umbrella</u> 100% Authorized	50% of \$5,000,000 each occurrence; \$10,000,000 excess of \$5,000,000, each occurrence.

As of December 31, 2004, the Company also maintained the following excess of loss coverage on a per occurrence basis:

<u>Type of Treaty</u>	<u>Cession</u>
<u>Property (3 layers)</u> 1 <sup>st</sup> layer 63.09% Authorized 2 <sup>nd</sup> layer 54.74% Authorized 3 <sup>rd</sup> layer 61.15% Authorized	95% of \$170,000,000 in excess of \$40,000,000, each loss occurrence.

As of December 31, 2004, the Company has in force the following facultative automatic excess of loss reinsurance agreement

<u>Type of Treaty</u>	<u>Cession</u>
<u>Property</u>	
100% Authorized	\$30,000,000 excess of \$10,000,000 each risk, for schools and condominiums.
100% Authorized	\$10,000,000 excess of \$10,000,000 each risk for graphic arts industries risks.

As of December 31, 2004, the Company has in force the following facultative binding excess of loss reinsurance agreement:

<u>Type of Treaty</u>	<u>Cession</u>
<u>Casualty</u>	
100% Authorized	90% of \$1,000,000, net loss each claim and 100% of \$1,000,000 excess of \$1,000,000 of net loss each claim of the employment related practices liability.

Since the last examination the Company has not changed its net retention of \$1,000,000 for both property and casualty business. The annual aggregate deductible increased from \$2.5 million to \$5 million for property business and from \$2.5 million to \$4.5 million for casualty business. The majority of the business was ceded to affiliated reinsurers as a result of pooling.

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 except the following:

- a. For several treaties, the extra contractual obligation clause was found to include a fraud and bad faith clause however; the fraud and bad faith clause did not state that it is allowable to the extent that such coverage is not contrary to the New York State Insurance Law.
- b. An “entire contract” clause was not included in all of the Company’s reinsurance contracts as required by SSAP No. 62, paragraph 8c.

It is recommended that the Company include the above noted required clauses in the Company’s reinsurance agreements.

It is the Company's policy that the legal department reviews a new contract clause or unfamiliar language in a reinsurance contract for both new and renewal contracts. In the CPA's work papers it was noted that this is "an informal process and there is no evidence of the legal department's review or comments provided." On examination, the Company could not provide documentation supporting their assertion that the legal department reviews reinsurance contracts that contain a new clause or unfamiliar language.

It is recommended that the Company establish a formal procedure for the documentation of contract reviews of reinsurance agreements.

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. On examination the Company could not provide analytic documentation to substantiate that the transfer of risk on its ceded reinsurance contracts was performed prior or subsequent to entering into those contracts. Representations were made by an attestation from the Company's chief executive officer pursuant to Department Circular Letter No. 8 (2005) that all of these contracts contained "self-evident risk transfer." Additionally, examination review indicated that the Company's ceded reinsurance contracts did not contain clauses indicating that they were a party to finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in paragraphs 41 to 44 of SSAP No. 62.

During the period covered by this examination, the Company commuted various ceded reinsurance agreements. The balances related to these commutations were not material.

The review of Note 26 to the Annual Statement revealed that the Company did not comply with SSAP No. 63, Paragraph 10 disclosure requirements for a reporting entity which is part of a group of affiliated entities which utilizes a pooling arrangement under which the pool participants cede substantially all of their direct and assumed business to the pools.

It is recommended that the Company comply with SSAP No. 63 financial statement disclosure requirements.

Subsequent to the examination date, the Company changed its primary reinsurance intermediary from J P Woods to Holborn, Inc. Uni-Service Excess Facilities Inc, a related party, acted as a secondary

reinsurance intermediary for the Company while J.P. Woods was the primary intermediary. All three reinsurance intermediaries are licensed in New York.

The Company could not provide documentation to support that reinsurance contract terms and expected results are properly documented prior to execution by the Reinsurance Senior Vice President.

It is recommended that the Company retain all documentation pertaining to its review of its reinsurance contracts prior to execution.

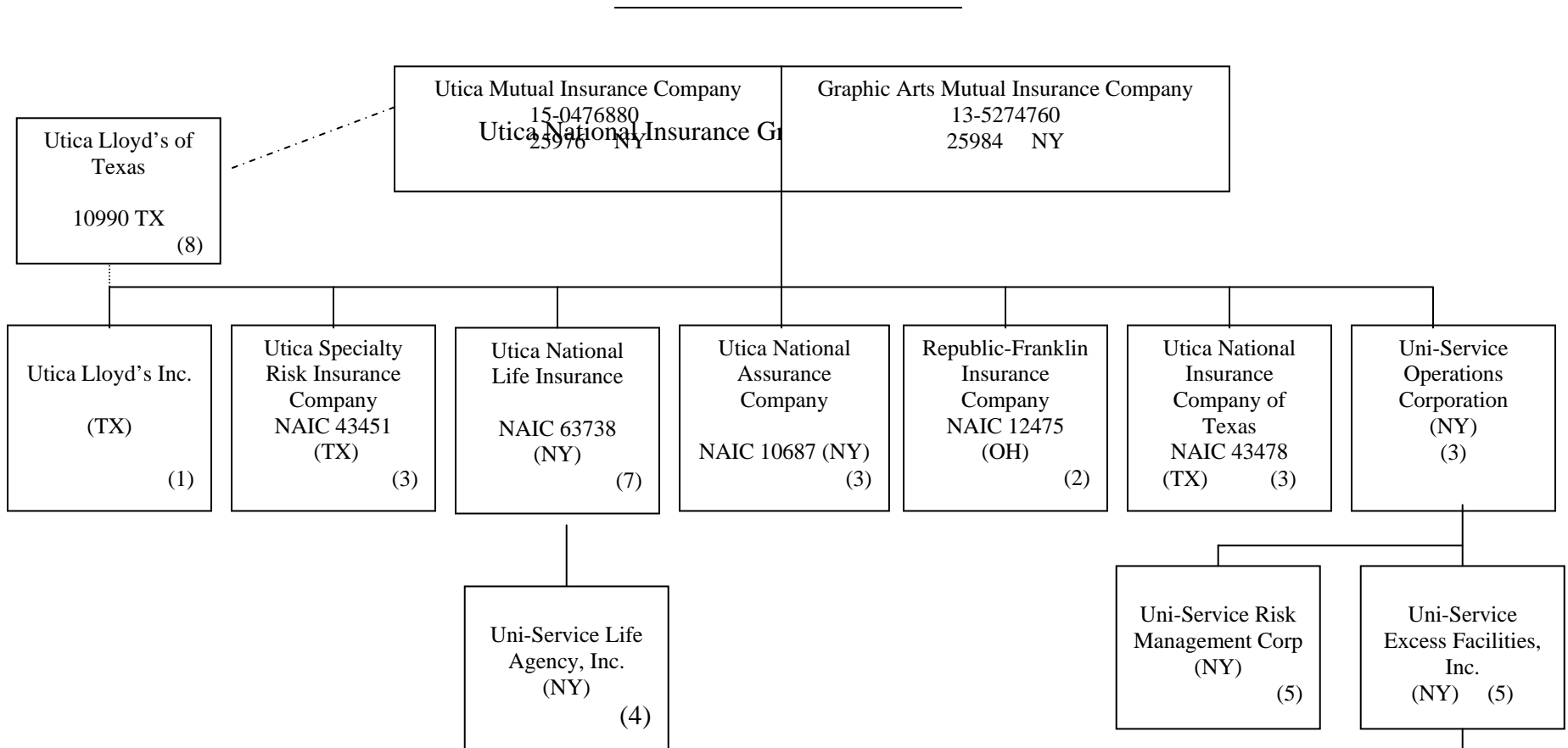
D. Affiliated Companies

The Company is not a member of a holding company as defined by Article 15 of the New York Insurance Law and is therefore not required to make filings specified by Department Regulation 52. However, effective August 13, 2001 the Company is responsible to make specified filings pursuant to Circular Letter No 17 (2001).

The Company and its various affiliates comprise the unincorporated entity known as Utica National Insurance Group (“Group”). On May 25, 2004, Republic-Franklin Insurance Company, a subsidiary of UMIC, discontinued the operations of its subsidiary, Utica (Bermuda) Limited. Utica (Bermuda) Limited has been removed from the chart.



The following is an organizational chart outlining the relationship between members of the Group at December 31, 2004:



- |   |   |
|---|---|
| 1. Owned 100% by Utica Mutual Insurance Company; operates as attorney-in-fact for Utica Lloyd's of Texas. | 5. Owned 100% by UNI-Service Operations Corporation   |
| 2. Owned 94% by Utica Mutual Insurance Company and 6% by Graphic Arts Mutual Insurance Company            | 6. Owned 100% by UNI-Service Excess Facilities Inc.   |
| 3. Owned 100% by Utica Mutual Insurance Company   | 7. Owned 79% by Utica Mutual Insurance Company and 21% by Graphic Arts Mutual Insurance Company.          |
| 4. Owned 100% by Utica National Life Insurance Company  | 8. A Texas Lloyds association of twelve underwriters under sponsorship of Utica Mutual Insurance Company. |

At December 31, 2004, the Company was party to the following agreements with other members of the Group:

- Common management agreement with Graphic Arts Mutual Insurance Company (This agreement was acknowledged by the Department on August 10, 1967.)
- Inter-Company pooling agreement with Graphic Arts Mutual Insurance Company, Republic-Franklin Insurance Company, Utica National Assurance Company, and Utica National Insurance Company of Texas (This agreement is described in Section 2C of this report.)
- Quota share assumption reinsurance agreement with Utica Specialty Risk Insurance Company
- Quota share assumption reinsurance agreement with Utica Lloyd's of Texas
- Expense allocation agreement with UNI-Service Excess Facilities and UNI-Service Excess Facilities Insurance Agency of New England
- Tax allocation agreement with Republic-Franklin Insurance Company, Utica National Assurance Company, Utica National Insurance Company of Texas, Utica Specialty Risk Insurance Company, Utica Lloyd's, Inc., UNI-Service Operations Corporation, UNI-Service Risk Management Corporation, UNI-Service Excess Facilities, and UNI-Service Excess Facilities Insurance Agency of New England.
- Service agreement to provide administrative, data processing, underwriting and claims services for Utica Specialty Risk Insurance Company.
- Service agreement to provide administrative, data processing, underwriting and claims services for Utica Lloyd's of Texas, Inc.
- Service agreement to provide administrative, data processing, underwriting and claims services for Utica National Life Insurance Company.
- Service agreement to provide administrative services for UNI-Service Operations Corporation.

The service agreements between UMIC and Utica Specialty Risk Insurance Company and UMIC and Utica Lloyd's of Texas, Inc. call for the investment expenses to be paid for by those subsidiaries. Review of the filed annual statements for the period under examination indicates that there was no investment expense for either Company. As such, the inter-company pool was assuming the expenses for these two Companies.

Section 1608(b) states that:

“All transactions between the insurer and its subsidiaries shall be fair and equitable, charges or fees for service performed shall be reasonable and all expenses incurred and payments received shall be allocated to the insurer on an equitable basis in conformity with customary insurance accounting practices consistently applied.”

It is recommended that the Company comply with Section 1608(b) of the New York Insurance Law and its inter-company service agreements with these two affiliates by charging each affiliated Company with the appropriate amount of the investment expenses for the services provided.

In 1999, the Company amended its previously approved tax allocation agreement. This amendment was in place for the entire examination period. Circular Letter No. 33 (1979) requires that all amendments to a tax allocation agreement be approved by the Company's board of directors and be submitted to the Department for non-disapproval. The Company could not provide documentation supporting the submission of this amended agreement to the Department nor could it provide substantiation that the agreement was approved by the Company's board of directors.

It is recommended that the Company comply with Department Circular Letter No. 33 (1979) and submit all amendments to its inter-company tax allocation agreements to the board of directors for approval and then to the Department for non-disapproval at least 30 days prior to the effective date of any changes to the agreement.

Further, the agreement states that settlement of any inter-company tax balances owed to all affiliates are made within 30 days of the filing of the applicable estimated or actual consolidated federal income tax return with the Internal Revenue Service. Review of the payments indicated that a number of payments were made after the 30 days required by the agreement.

It is recommended that the Company comply with its tax allocation agreement and settle its inter-company balances within 30 days of the filing of the applicable estimated or actual consolidated federal income tax return with the Internal Revenue Service.

On September 10, 2004, the Utica Mutual Insurance Company and Utica National Assurance Company engaged in a “security swap” in which UMIC transferred to UNAC certain GNMA securities in exchange for various mortgage-backed and corporate bonds. In this exchange, UMIC transferred assets valued at \$10,627,890 par value or \$11,137,123 fair market value to UNAC for assets valued at \$10,850,249 par value or \$11,346,091 fair market value. The difference in market values for the securities “swapped”, \$208,968, was paid in cash by UMIC to UNAC.

The security swap was done to bring UNAC into compliance with Article 14 of the New York Insurance Law.

Circular Letter No. 17 (2001) states in part:

“Beginning September 1, 2001, every authorized domestic insurer that is exempt from the provisions of Article 15 of the New York Insurance Law is hereby directed, pursuant to Section 308 of the New York Insurance Law, to furnish this Department by e-mail with a report on the attached Form CL 17 (2001), at least 30 days in advance of entering into any of the following transactions . . .

- Sales, purchases, exchanges, loans, extensions of credit, or investments with an affiliate, provided the transactions are equal to or exceed:
- With respect to non-life insurers, the lesser of three percent (3%) of the insurer’s admitted assets or twenty-five percent (25%) of surplus to policyholders . . . as of the 31<sup>st</sup> day of December next preceding . . .

The amount of this transaction exceeds the benchmark set by the Circular Letter for UNAC and was not reported to the Department on Form CL 17 (2001) as required by the Circular Letter.

Further, it was noted that the sales / acquisitions of securities were transferred at book value, not market value and as such no gain or loss was recognized by either company. The Company indicated that this was done due to limitations of their investment system at the time of

the transfer and so as not to recognize a gain prior to the actual disposal of the investment security.

It is recommended that the Companies comply with Circular Letter No. 17 (2001) and report all transactions exceeding the benchmarks, on the required form, to this Department at least 30 days prior to entering into such transaction.

It is further recommended that the Companies comply with the National Association of Insurance Commissioners' Annual Statement Instructions and properly report all sales and acquisitions of securities and the related investment gains and losses in all future statements filed with this Department.

E. Abandoned Property Law

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

The Company's abandoned property reports for the period of this examination were all filed on a timely basis pursuant to the provisions of Section 1316 of the New York Abandoned Property Law.

As noted in Section 2D of this report, Utica Specialty Risk Insurance Company is a wholly owned subsidiary of UMIC and has entered into a service agreement with Utica Specialty Risk Insurance Company to provide services to that Company. On examination it was determined that Utica Specialty Risk Insurance Company did not make the filings required by Section 1316 of the New York Abandoned Property Law.

Subsequent to the examination date, the Company made the requisite filings.

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 2004, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	1.22	to 1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	90.55%	
Premiums in course of collection to surplus as regards policyholders	28.15%	

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 five-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$2,367,307,789	81.98%
Other underwriting expenses incurred	931,892,074	32.27
Net underwriting loss	<u>(411,577,243)</u>	<u>(14.25)</u>
Premiums earned	<u>\$2,887,622,620</u>	<u>100.00%</u>

G. Accounts and Records

a. Uncollected Premiums and Agents' Balances

On examination it was noted that the Company was reducing the non-admitted portion of uncollected premiums as noted below:

- When an insured has multiple policies with the same agent, and the net amount for all the policies show a credit balance, the Company reduces the non-admitted amount by the amount owed for that policy;
- If the agent reports that they have received money from the insured, the Company reduces the balance owed by that amount. (The Company is treating payment to the agent as payment to the Company.)

- When an insured has multiple policies with the Company and one policy has a credit balance on a direct billed policy and a balance over 90 days past due on an agency billed policy, the credit balance is used to off-set the over due balance.

This accounting treatment noted above is not in accordance with SSAP No. 6, paragraph 9, which states:

“Nonadmitted amounts are determined as follows:

- a. **Uncollected Premium**—To the extent that there is no related unearned premium, any uncollected premium balances which are over ninety days due shall be nonadmitted. If an installment premium is over ninety days due, the amount over ninety days due plus all future installments that have been recorded on that policy shall be nonadmitted;
- b. **Bills Receivable**—Bills receivable shall be nonadmitted if either of the following conditions is present:
  - i. If any installment is past due, the entire bills receivable balance from that policy is nonadmitted; or
  - ii. If the bills receivable balance due exceeds the unearned premium on the policy for which the note was accepted, the amount in excess of the unearned premium is nonadmitted.
- c. **Agents' Balances**—The uncollected agent's receivable on a policy by policy basis which is over ninety days due shall be nonadmitted regardless of any unearned premium;
  - i. If amounts are both payable to and receivable from an agent on the same underlying policy, and the contractual agreements between the agent and the reporting entity permit offsetting, the nonadmitted portion of amounts due from that agent shall not be greater than the net balance due, by agent;
  - ii. If reconciling items between a reporting entity's account and an agent's account are over ninety days due, the amounts shall be nonadmitted.”

Based on the statutory accounting guidance noted above, the Company should have non-admitted that portion of the asset that did not comply with SSAP No. 6.

It is recommended that the Company comply with SSAP No. 6, Paragraph 9 when determining its nonadmitted uncollected premiums and agents' balances.

It is recommended that the Company comply with SSAP No. 4 by not reducing the non-admitted portion of its premium balances due by amounts in the control of others.

The changes caused by these procedures are not material to the examination and, therefore, no financial adjustments will be made.

b. Certified Public Accountant Engagement Letter

On examination it is determined that that the engagement letter entered into between Utica Mutual Insurance Company and PricewaterhouseCoopers, LLP, its independent auditor, is not in compliance with New York State Department Regulation 118. According to Part 89.2 of Department Regulation No. 118, such contract must specify the following:

“(a) on or before May 31<sup>st</sup>, the CPA shall provide an audited financial statement of such insurer and of any subsidiary required by section 307(b)(1) of the Insurance Law together with an opinion on the financial statements of such insurer and any such subsidiary for the prior calendar year and an evaluation of the insurer’s and any such subsidiary’s accounting procedures and internal control systems as are necessary to the furnishing of the opinion;

(b) any determination by the CPA that the insurer has materially misstated its financial condition as reported to the superintendent or that the insurer does not meet minimum capital or surplus to policyholder requirements set forth in the Insurance Law shall be given by the CPA, in writing, to the superintendent within 15 calendar days following such determination; and

(c) the workpapers and any communications between the CPA and the insurer relating to the audit of the insurer shall be made available for review by the superintendent at the offices of the insurer, at the Insurance Department or at any other reasonable place designated by the superintendent. The CPA must retain for review such workpapers and communications in accordance with the provisions of Part 243 of this Title (Regulation 152). More specifically, such workpapers and communications must be retained by the CPA for the period specified in sections 243.2(b)(7) and (c) of this Title. For the purposes of this subdivision, the workpapers and communications shall be deemed to have been created on the date the filing required by section 89.2(a) of this Part was submitted to the superintendent.”

The engagement letter entered into between the company and Pricewaterhouse Coopers LLP, dated November 10, 2004 for the 2004 audit period contained none of the required provisions. As a result, the contract between Utica National Insurance Group and the independent auditor is not in compliance with Department Regulation 118.

It is recommended that the Company comply with Department Regulation 118 by entering into future contracts with its independent auditor that contains the requisite provisions.



c. Custodial Agreement

The examination reviewed the custodial agreement between the Company and the Bank of New York, the Company's custodian. The custodial agreement lacked the following safeguards and controls required by Part 1, Section IV(J) of the NAIC Financial Condition Examiners Handbook.

2a. The custodian is obligated to indemnify the insurance company for any insurance company's loss of securities in the custodian's custody, except that, unless domiciliary state law, regulation, or administrative action otherwise require a stricter standard (Section 2.b. sets forth an example of such a stricter standard), the bank or trust company shall not be so obligated to the extent that such loss was caused by other than the negligence or dishonesty of the custodian . . .

2c. In the event of a loss of the securities for which the custodian is obligated to indemnify the insurance company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced . . .

2e. In the event that the custodian gains entry in a clearing corporation through an agent, there should be a written agreement between the custodian and the agent that the agent shall be subjected to the same liability for loss of securities as the custodian. If the agent is governed by laws that differ from the regulation of the custodian, the Commissioner of Insurance of the state of domicile may accept a standard of liability applicable to the agent that is different from the standard liability

2f. If the custodial agreement has been terminated or if 100% of the account assets in any one custody account have been withdrawn, the custodian shall provide written notification, within three business days of termination or withdrawal, to the insurer's domiciliary commissioner; . .

2h. The custodian and its agents, upon reasonable request, shall be required to send all reports which they receive from a clearing corporation or the Federal Reserve book-entry system which the clearing corporation or the Federal Reserve permits to be redistributed and reports prepared by the custodian's outside auditors, to the insurance company on their respective systems of internal control . . .

2i. To the extent that certain information maintained by the custodian is relied upon by the insurance company in preparation of its annual statement and supporting schedules, the custodian agrees to maintain records sufficient to verify such information. (The agreement falls short - it only agrees to "make reasonable effort to procure" this information.)

2l. The foreign bank acting as a custodian, or a U.S. custodian's foreign agent, or a foreign clearing corporation is only holding foreign securities or securities required

by the foreign country in order for the insurer to do business in that country. A US custodian must hold all other securities.

It was further noted that the Companies answered "yes" to the General Interrogatory # 23 in the filed annual statements at December 31, 2004, and listed the Bank of New York custodial agreement as an agreement that complied with the NAIC Financial Condition Examiners Handbook.

It is recommended that the Companies comply with Part 1 Section IV(J) of the NAIC's Financial Condition Examiner's Handbook by revising its custodial agreements to include all of the requisite safeguards and controls.

It is further recommended that the Companies respond appropriately to the general interrogatories in all future statements filed with this Department.

d. Preparation of the Annual Statement

The examination noted several instances where the filed annual statement was not prepared in accordance with the NAIC Annual Statement Instructions. It was noted that certain line accounts for both assets and liabilities were reported as write-in items (i.e. "Receivable for securities" and "Loans to agents" were reported as "Aggregate write-in assets" and "Advance premiums" were reported as an "Aggregate write-in liability"); certain balance sheet accounts were reported on the incorrect line (i.e. certain "Commissions payable" were netted against "Uncollected premiums" rather than as a liability for "Commissions payable" and unidentified cash receipts, premium payments greater than the amount billed and deposits for policies that have been issued were reported as reductions to agents' balances or as a write-in liability rather than as a liability for "Remittances and items not allocated"); some accounts were netted against other accounts where a right to off-set did not exist; certain Schedule D data was incorrect (i.e. certain loaned securities were not designated LS, inaccurate trade dates, etc.); and a number of disclosures stated in the "Notes to Financial Statements" were either incorrect or incomplete (Notes 1, 23, 24,26,27).

It is recommended that the Company exercise more care in the preparation of its filed statements and fully comply with the NAIC Annual Statement Instructions for all future statements filed with this Department.

e. Internal Controls

i. Manual Journal Entries

The Company has no formal written policy regarding the posting of manual entries to the Company's journals. The Company limits who is authorized and has the ability to make these entries, but there is no written policy regarding this.

It is recommended that the Company institute a formal approval policy to document and control manual entries made to the Company's books and records.

ii. Surety Bonds

The examination noted several internal control deficiencies regarding the issuance of surety bonds. These deficiencies included lack of documentation, incomplete applications, reconciliation of the powers of attorney and inadequate record keeping by agents.

It is recommended that the Company institute the necessary internal controls to prevent possible defalcation of the bonds.

iii. Draft Control

Twice during the examination period the Company lost drafts. After the first occurrence, the Company's internal audit unit recommended that certain controls be instituted to ensure the safety of the drafts. The recommended controls were only partially instituted prior to the second loss. Further, the examination noted that one claims office was using drafts out of sequence and the draft log at that office was incomplete.

Further, the drafts had no dollar limitation spelled out on the draft, there is no formal procedure to count the drafts held at agencies and there is no list of authorized agency signatories.

It is recommended that the Company strengthen its controls of draft stock.

It is recommended that the Company count the drafts held at the agencies during the agency audit process.

It is recommended that the Company require each agency to submit a list of authorized signatories.

iv. Review of investment managers

The Company failed to perform the necessary “due diligence” on one of its investment managers. In response to the Department question “Does management periodically evaluate the financial condition and capabilities of bank, broker/dealers, servicing agents, property managers and others with whom the insurer has established business relationships” the Company stated that they relied on SAS 70 reports prepared by the entities’ certified public accountant.

The examination was notified by the investment manager that a SAS 70 was not performed on their Company. Further, the Company could provide no substantiation that it had performed a review of this entity other than a recommendation from an external consultant.

It is recommended that the Company perform the necessary “due diligence” on all banks, broker/dealers, servicing agents, property managers and others with whom the insurer has established a business relationship.

Subsequent to the examination date the Company severed its relationship with this investment manager.

f. Record Retention

During the review of the Company’s claims data it was noted that there were a substantial number of gaps present in the claim numbers recorded in that database. The gaps in the claim numbers result from errors in the initial keying/ creation of the claim. The gaps represent situations where keying errors have occurred and are corrected by deletion of the initial claim and the re-keying of the information using a new claim number. When these deletions are made, the Company’s system generates a report of the claim number that was deleted. However, that report is only maintained for a period of thirty-seven days.

Department Regulation 152 requires the records to be held for six calendar years from creation or until the filing of the report on examination in which the record was subject to review, whichever is longer.

It is recommended that the Company retain this report and any similar reports that capture the detail of the information keyed on a claim prior to its deletion.

Subsequent to the examination, the Company instituted a program to retain this information for the period required by Department Regulation 152.

g. Overdue Receivable

On examination it was noted that the Company recorded a liability on a paid loss recoverable on a high deductible policy that was more than 90 days past due and of doubtful collectability. The Company carried this reserve as part of a write-in item on the asset page of its filed Annual Statement.

Section 1302(b) of the New York Insurance Law instructs the insurer to non-admit all assets of doubtful value.

It is recommended that the Company comply with Section 1302(b) of the New York Insurance Law and non-admit all assets of doubtful value.

It should be noted that the amount of the past due amount was not significant and no change to surplus will be made.

h. Allocation of expenses

The examination reviewed the manner in which the Company allocates its expenses and the compliance of this allocation with Department Regulation 30. The following was noted:

- The Company did not allocate any investment expense to Utica Lloyds of Texas and Utica Specialty Risk Insurance Company in accordance with its inter-company agreement.
- Department Regulation 30 requires that the Company produce and maintain an “Allocation of salaries, recapitulation of salaries, and detail of allocation bases”

for each 12 month period. The Company did not produce this allocation of salaries.

It is recommended that the Company produce and maintain the records in the form and manner required by Department Regulation 30.

H. Expense Limitations for Mutual Companies

Section 4110(a) of the New York Insurance Law provides that no domestic mutual property/casualty insurance company “shall expend in any one calendar year for management expenses a greater amount than thirty percent of its net premium income for such year.” Review of the expenses for the five-year period under examination revealed that the Company exceeded the management expense limits in all five years.

It is recommended that the Company comply with the management expense limitations set forth in Section 4110(a) of the New York Insurance Law.

### 3. FINANCIAL STATEMENTS

#### A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2004 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Examination</u>	Net Admitted	<u>Company</u>	Surplus
		Assets Not <u>Admitted</u>	<u>Assets</u>	Net Admitted <u>Assets</u>	Increase <u>(Decrease)</u>
Bonds	\$1,448,425,445	\$1,731,703	\$1,446,693,742	\$1,448,425,445	\$(1,731,703)
Preferred stocks	6,104,043	0	6,104,043	6,104,043	0
Common stocks	193,271,658	0	193,271,658	193,271,658	0
Properties occupied by the Company	18,392,086	0	18,392,086	18,392,086	0
Cash, cash equivalents and short-term investments	45,454,575	0	45,454,575	45,454,575	0
Other invested assets	7,352,333	0	7,352,333	7,352,333	0
Investment income due and accrued	17,085,330	0	17,085,330	17,085,330	0
Uncollected premiums and agents' balances in the course of collection	138,600,662	2,479,711	136,120,951	134,128,533	1,992,418
Deferred premiums, agents' balances and installments booked but deferred and not yet due	49,247,506	314,985	48,932,521	48,932,521	0
Accrued retrospective premiums	253,935	25,393	228,542	228,542	0
Amounts recoverable from reinsurers	24,307,463	0	24,307,463	24,307,463	0
Current federal and foreign income tax recoverable and interest thereon	7,353,059	0	7,353,059	7,353,059	0
Net deferred tax asset	25,547,603	4,357,703	21,189,900	25,547,603	(4,357,703)
Guaranty funds receivable or on deposit	2,891,351	0	2,891,351	2,891,351	0
Electronic data processing equipment and software	1,480,829	0	1,480,829	1,480,829	0
Furniture and equipment, including health care delivery assets	2,665,569	2,665,569	0	0	0
Receivables from parent, subsidiaries and affiliates	1,202,115	0	1,202,115	1,202,115	0
Other assets nonadmitted	1,036,906	1,036,906	0	0	0
Aggregate write-ins for other than invested assets	<u>33,589,300</u>	<u>21,000,444</u>	<u>12,588,856</u>	<u>12,588,856</u>	<u>0</u>
Total assets	<u>\$2,024,261,768</u>	<u>\$33,612,414</u>	<u>\$1,990,649,354</u>	<u>\$1,994,746,341</u>	<u>\$(4,096,988)</u>

<u>Liabilities, Surplus and Other Funds</u>	<u>Examination</u>	<u>Company</u>	<u>Surplus Increase (Decrease)</u>
<u>Liabilities</u>			
Losses and loss adjustment expenses	\$1,065,467,835	\$1,049,962,835	\$(15,505,000)
Reinsurance payable on paid losses and loss adjustment expenses	0	0	0
Commissions payable, contingent commissions and other similar charges	19,606,676	15,660,705	(3,945,971)
Other expenses (excluding taxes, licenses and fees)	32,958,416	36,051,476	3,093,060
Taxes, licenses and fees (excluding federal and foreign income taxes)	20,389,856	20,389,856	0
Borrowed money and interest thereon	5,510,000	5,510,000	0
Unearned premiums	290,328,765	290,328,765	0
Policyholders (dividends declared and unpaid)	10,082,766	10,082,766	0
Ceded reinsurance premiums payable (net of ceding commissions)	8,094,425	8,094,425	0
Funds held by company under reinsurance treaties	2,686,160	2,686,160	0
Amounts withheld or retained by company for account of others	12,505,532	12,505,532	0
Provision for reinsurance	16,254,735	16,254,735	0
Net adjustments in assets and liabilities due to foreign exchange rates	1,173,873	1,173,873	0
Drafts outstanding	146,994	146,994	0
Aggregate write-ins for liabilities	<u>15,611,469</u>	<u>15,611,469</u>	<u>0</u>
 Total liabilities	 <u>\$1,500,817,502</u>	 <u>\$1,484,459,591</u>	 \$( 16,357,911)
<u>Surplus and Other Funds</u>			
Aggregate write-ins for special surplus funds	\$4,836,383	\$4,836,383	\$ 0
Aggregate write-ins for other than special surplus funds	1,700,000	1,700,000	<u>0</u>
Unassigned funds (surplus)	<u>483,295,467</u>	<u>503,750,366</u>	<u>\$(20,454,899)</u>
Surplus as regards policyholders	<u>\$ 489,831,850</u>	<u>\$ 510,286,749</u>	<u>\$(20,454,899)</u>
 Total liabilities, surplus and other funds	 <u>\$1,990,649,352</u>	 <u>\$1,994,746,341</u>	

NOTE: The Internal Revenue Service has completed its audits of the Company's consolidated Federal Income Tax returns through tax year 2001. All material adjustments, if any, made subsequent to the date of examination and arising from said audits, are reflected in the financial statements included in this report. The Internal Revenue Service is scheduled to begin the audit of the tax returns covering tax years 2002, 2003 and 2004. 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 \$25,140,610 during the five-year examination period January 1, 2000 through December 31, 2004, detailed as follows:

Underwriting Income

Premiums earned		\$2,887,622,620
Deductions:		
Loss and Loss adjustment expenses incurred	\$2,367,307,789	
Other underwriting expenses incurred	931,892,074	
Aggregate write-ins for underwriting deductions	<u>0</u>	
Total underwriting deductions		<u>3,299,199,863</u>
Net underwriting gain or (loss)		\$ (411,577,243)
Investment Income		
Net investment income earned	\$ 425,534,797	
Net realized capital gain	<u>29,934,391</u>	
Net investment gain or (loss)		455,469,188
Other Income		
Net gain or (loss) from agents' or premium balances charged off	\$ (9,447,159)	
Finance and service charges not included in premiums	10,643,261	
Aggregate write-ins for miscellaneous income	<u>(10,085,518)</u>	
Total other income		<u>(8,889,416)</u>
Net income before dividends to policyholders and before federal and foreign income taxes		\$ 35,002,529
Dividends to policyholders		<u>52,307,846</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$ (17,305,317)
Federal and foreign income taxes incurred		<u>(7,270,334)</u>
Net Income		<u>\$ (10,034,983)</u>

### C. Capital and Surplus Accounts

Surplus as regards policyholders per report on examination as of December 31, 1999			\$464,691,240
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income		\$10,034,981	
Net unrealized capital gains or (losses)	\$30,601,094		
Change in net unrealized foreign exchange capital gain (loss)		303,001	
Change in net deferred income tax	11,211,716		
Change in nonadmitted assets	4,095,207		
Change in provision for reinsurance		552,130	
Cumulative effect of changes in accounting principles		7,566,851	
Aggregate write-ins for gains and losses in surplus		<u>2,310,444</u>	
Total gains and losses	<u>\$45,908,017</u>	<u>\$20,767,407</u>	
Net increase (decrease) in surplus			<u>25,140,610</u>
Surplus as regards policyholders per report on examination as of December 31, 2004			<u>\$489,831,850</u>

### 4. BONDS

The examination admitted asset of \$1,446,484,774 is \$1,731,703 less than the \$1,448,425,445 reported by the Company in its December 31, 2004, filed annual statement. The examination change is due to the Company's computation of the amortization of bonds bought at a premium and the swapping of securities with UNAC, as noted in Section 2D of this report.

The Company calculated the amortization of bonds bought at a premium or discount using the maturity date rather than the call or maturity value date that yields the lowest asset value. Paragraph 6 of the NAIC's SSAP No. 26, paragraph 6 states:

*"Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond. Bonds containing call provisions (where the issue can be called away from the reporting entity at the issuer's discretion) shall be amortized to the call or maturity value/date which produces the lowest asset value (yield to worst)."*

By using the maturity date to calculate the amortization, the Company overstated its reported valuation of bonds by \$1,731,703.

It is recommended that the Company amortize its bond assets in accordance with the NAIC's SSAP No. 26.

**5. UNCOLLECTED PREMIUMS AND AGENTS' BALANCES IN THE COURSE OF COLLECTION**

The examination admitted asset of \$136,120,951 is \$1,992,418 more than the \$134,128,533 reported by the Company in its December 31, 2004, filed annual statement. The examination change consists of the following:

- Increase of \$3,838,147 representing commissions payable on direct billed premiums, which has been reclassified as a liability under the caption 'Commissions payable.' (See item 8 in this report).
- Increase of \$1,247,331 representing commissions payable to brokers, which has been reclassified as a liability under the caption 'Commissions payable.' (See item 8 in this report). It is noted that the amount was also incorrect - it should have been \$107,824.
- Decrease of \$3,093,060 representing commissions payable for agency billed policies, which was reported under the caption 'Other expenses' in the Company's filed annual statement. This item has been reclassified as a reduction to the captioned asset pursuant to SSAP No. 6, paragraph 6 which states that premiums owed by agents shall be reflected net of commissions. (See item 9 in this report).

**6. NET DEFERRED TAX ASSET**

The examination admitted asset of \$21,189,900 is \$4,357,703 less than the \$25,547,603 reported by the Company in its December 31, 2004, filed annual statement. The examination change is due to the Company including the proposed gain on the sale of Utica Life Insurance Company ("ULIC"), a 79% owned affiliate in determining the tax limit for its effective deferred tax asset.

The Company had a prospective buyer for ULIC; however, it had not entered into a formal contract with that prospective buyer. The estimate of the valuation of the profit on the sale of the life company portion of the deferred tax asset was based on an actuarial assumption of

the future cash flows of ULIC rather than a buy/sell agreement with a prospective buyer. To date, the Company has not entered into an agreement to sell that Company.

SSAP No. 10, paragraph 5, states in part:

“A reporting entity’s balance sheet shall include deferred income tax assets (DTA’s) and liabilities (DTL’s), the *expected* future tax consequences of temporary differences generated by statutory accounting, as defined in paragraph 11 of FAS 109” (*emphasis added.*)

A possible sale of Company assets does not qualify as an “*expected future tax consequence*” since there is no reasonable expectation that the sale would be completed. The Company could provide no definitive statutory guidance to support this potential sale as a deferred tax asset. Given that the sale has yet to materialize, it would be appropriate for the Company to exclude the tax benefit on the potential sale of this property.

Upon examination, the Company provided a reconciliation of the deferred tax asset indicating that the Bond basis of Schedule D/DA was \$1,451,130,256. Note to Financial Statement #9, in the Company’s filed annual statement showed a balance for this item of \$1,469,356,256 that is \$226,000 greater than the amount provided in the reconciliation. It was determined that the account reconciliation was correct and the amount reported in the Company’s filed annual statement was in error.

A recommendation regarding the preparation of its future filed annual statements is previously cited in this report.

## **7. LOSSES AND LOSS ADJUSTMENT EXPENSES**

The examination liability of \$1,065,467,835 is \$15,505,000 more than the \$1,049,962,835 reported by the Company in its December 31, 2004, filed annual statement. The examination change is due to the following:

- One-year development of losses and allocated loss adjustment expenses in the amount of \$14,816,000 as reported by the Company in its 2005 filed annual statement;

- One-year development of Adjusting and other expenses in the amount \$689,000 as reported by the Company in its 2005 filed annual statement.

The examination analysis of the loss and loss adjustment expense reserves 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 Department's actuarial review also concluded that the actuarial report presented on examination did not comply with the NAIC Annual Statement Instructions and did not contain the requisite documentation for an actuarial report. The actuarial report did not include any documentation of the Schedule P reconciliation nor the ULAE reserve analysis. Pursuant to the NAIC Annual Statement Instructions, paragraph 7 of the Actuarial Opinion section states, in part;

“The Actuarial Report should be consistent with the documentation and disclosure requirements of ASOP #9. The Actuarial Report should contain both narrative and technical components. The narrative component should provide sufficient detail to clearly explain to company management, the regulator, or other authority the findings, recommendation and conclusions, as well as their significance. The technical component should provide sufficient documentation and disclosure for another actuary practicing in the same field to evaluate the work. This technical component must show the analysis from the basic data, e.g., loss triangles, to the conclusions.

The report must also include:

- An exhibit which ties to the Annual Statement and compare the Actuary's conclusions to the carried amounts;
- Summary exhibit(s) of either the actuary's best estimate, range of reasonable estimates, or both, that led to the conclusion in the OPINION paragraph regarding the reasonableness of the provision for all unpaid loss and loss adjustment obligations;
- Documentation of the required reconciliation from the data used for analysis to the Annual Statement Schedule P.”

The actuarial report must also include all exhibits and documentation including a narrative to clearly explain the assumptions and methodology used regarding the “Adjusting and other expense” reserve analysis.

It should be noted that the Company and the Company's actuary did not provide timely responses and clarification of questions to this Department. This had the consequence of hindering the review and taxing the Department's resources.

It is recommended that the Company ensure that the actuarial report is prepared in accordance with the NAIC Annual Statement Instructions and include all exhibits and documentation including a narrative to clearly explain the assumption and methodology used regarding the Adjusting and other expense reserve analysis.

It is recommended that the Company's actuarial unit prepare and include in the actuarial report the requisite exhibits and documentation and provide the same to the examination in a timely manner.

On November 14, 2004, the Company's board of directors approved the appointment of a new actuary to opine on the losses and loss adjustment expenses in conjunction with the 2004 annual statement filings. The NAIC instructions for the 2004 annual statement pertaining to the Actuarial Opinion include the following directions:

“The Qualified Actuary must be appointed by the Board of Directors, or its equivalent, or by a committee of the Board, by December 31 of the calendar year for which the opinion is rendered. Whenever the Board of Directors replaces the appointed actuary, the company must notify the domiciliary commissioner *within 30 days of the date of the Board action* and give the reasons for the replacement (emphasis added).”

The Company failed to notify this Department within the time frame specified in the annual statement instructions. The notification was dated May 11, 2005.

It is recommended that the Company comply with the NAIC Annual Statement Instructions and report all future changes of actuaries within the timeframe and in the manner prescribed by those instructions.

## **8. COMMISSIONS PAYABLE**

The examination liability of \$19,606,676 is \$3,945,971 more than the \$15,660,705 reported by the Company in its December 31, 2004 filed annual statement. The examination change is due to the misclassification and miscalculation of this liability.

This change was made up of the following:

- Increase of \$3,838,147 representing commissions payable for direct billed premiums, which the Company reported as a reduction to the admitted asset “uncollected premiums and agents’ balances in course of collection”, and which has been reclassified to the captioned liability. (See item 5 in this report).
- Increase of \$107,824 representing commissions payable to brokers, which the Company reported as a reduction to the admitted asset “uncollected premiums and agents’ balances in course of collection”, and which has been reclassified to the captioned liability. The amount was also incorrectly reported by the Company as \$1,247,331. (See item 5 in this report).

## **9. OTHER EXPENSE**

The examination liability of \$32,958,416 is \$3,093,060 less than the \$36,051,476 reported by the Company in its December 31, 2004, filed annual statement. The examination change is due to the reporting of “Commissions payable” for agency billed policies as other expenses in the Company’s filed annual statement. These should have been reported as a reduction of uncollected premiums and agents balances on line 12 of the annual statement, pursuant to SSAP No. 6, paragraph 6.

## 10. MARKET CONDUCT ACTIVITIES

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

The general review was directed at practices of the Company in the following areas:

- A. Sales and advertising
- B. Underwriting
- C. Claims and complaint handling

The following problem areas were encountered in the examination of the Company's market conduct.

### Underwriting

The examination reviewed compliance with Department Regulation 90 which requires that specific wording be included in each notice of cancellation or non-renewal of a personal lines policy by the Company. Department Regulation 90 states in part:

(a) The following notice shall be clearly and prominently set out in boldface type on the front (except that the company name, company representative, company address and company phone number may be stamped, or typed in the appropriate place in the notice), so that it draws the reader's attention on all notices of refusal to issue, cancellation or non-renewal, except where the cancellation is for nonpayment of premium; and on all notices of termination of agents' and brokers' contracts or accounts, which are subject to this Part mailed or delivered on and after January 1, 1988:

"If you have any questions in regard to this termination, please contact this company's representative at (company phone number, name of company representative, company address).

The New York Insurance Law prohibits insurers from engaging in redlining practices based upon geographic location of the risk or the producer. If you have any reason to believe that we have acted in violation of such law, you may file your complaint with the Department either on its website at [www.ins.state.ny.us/complhow.htm](http://www.ins.state.ny.us/complhow.htm) or by writing to the State of New York Insurance Department, Consumer Services Bureau,



at either 25 Beaver Street, New York, NY 10004 or One Commerce Plaza, Albany, 12257.”

The sampled cancellations/non-renewals selected for review on examination shows that the Company is not in compliance with Department Regulation 90. The policy terminations did not include the website address the insured could use to file a complaint.

It is recommended that the Company revise its policy system to include the requisite wording of Department Regulation 90.

Subsequent to the examination date the Company revised its policy system to include the requisite wording.

#### Claims and Complaint Handling

Department Regulation 64 requires that each claims examiner have a copy of the Regulation available to each examiner at their workstation. UMIC fulfils that requirement by loading a copy of this Regulation on its intranet site. Review of the Company's intranet site indicated that the version of Department Regulation 64 was outdated.

It is recommended that the Company ensure that the current version of Department Regulation 64 is available to all persons administering claims settlement as required therein.

The Company's complaint log was reviewed to determine if this log was in compliance with Circular Letter No. 11 (1978). This review indicates that the log did not contain the data or the structure required by Circular Letter No. (1978). The following exceptions were noted:

The Company's complaint log did not include the following data columns:

- The New York State Insurance Department file number.
- The person in the company with whom the complainant has been dealing.
- The person within the company to whom the matter has been referred for review.
- The date of such referral.
- Bearing in mind the appropriate regulation mandating timely substantive replies, the dates of correspondence to the Insurance Department's Consumer Services Bureau.

- A. The acknowledgment (if any).
  - B. The date of any substantive response.
  - C. The chronology of further contacts with this Department.
- The results of the complaint investigation and the action taken.
  - Remarks about internal remedial action taken as a result of the investigation.

In addition, it was observed that the Company was not fully compliant with the circular letter because they were not generating and circulating quarterly reports to the head of the respective operating units and to the Company president as required.

During the aforementioned review, the examination also noted that the Company incorporated all of the complaints into one central complaint log with no way of distinguishing the complaints of one company in the group from another. Since the Department generates its complaint log by individual company, the failure of the Company's complaint log to be separated by Company requires the examiners to cross-reference all complaints tested prior to reviewing those complaints.

Further, the inability to review the number and type of complaints for each company did not allow the examiners to determine if an explicit type of complaint or a complaint relating to a specific company, line or class of business was prevalent.

Circular Letter No. 11 (1978) states that the purpose of the complaint log is to be a "tool to identify any problem areas within the Company." Therefore, it is incumbent on the Company to maintain the log in such a manner as to easily identify specific problems.

It is recommended that the Company revise its complaint log to incorporate the data with the requisite column headings as required by Circular Letter No. 11 (1978).

It is recommended that the Company generate quarterly reports and forward them to the heads of the respective operating units and to the Company president.

In addition, it is recommended that management either generate separate logs for each Company or include an identifier of the Company in the Utica National Insurance Group that generated the complaint.

It was observed that management and supervisors at the Albany district claims office have settlement on fidelity bond claims at various levels up to \$200,000 despite the fact that all fidelity claims were settled by the home office. This authority was given to the district claim office during Utica National Insurance Group's preparation for Y2K and was not subsequently withdrawn.

It is recommended that the Company update the settlement authority for claims to conform to its currently approved procedures.

The Company established criteria in its claims manual requiring that a claims payment in excess of \$20,000 have the signature of the unit supervisor and the claims office manager. Review of the sampled claims indicates that the checks for environmental claims in excess of \$20,000 were signed by two attorneys adjusting the claims rather than the signature of the unit supervisor and the claims office manager.

It is recommended that the Company either comply with their written procedures or amend the procedures to conform to its current practice.

## 11. 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>Affiliated Companies</u>	
i.     It is recommended that the Company obtain the superintendent's approval for the exact amount for any future surplus contributions to its insurance subsidiaries, pursuant to Section 1408(b) of the New York Insurance Law.	13
ii.    The Company has complied with this recommendation.	
ii.    It is recommended that the Company formalize its business relationship with UNI-Service Operations Corporation with a valid contract.	15
ii.    The Company has complied with this recommendation.	
B. <u>Insurance Coverage</u>	
It is recommended that the Company only issue insurance policies to parties other than itself, in accordance with Section 1101(a) of the New York Insurance Law.	17
The Company has complied with this recommendation.	

## 12. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
i. It is recommended that the Company comply with the Section 1209(b) of the New York Insurance Law by reducing the number of directors who are neither members of the corporation nor officers of member corporations to four.	6
ii. It is recommended that the executive committee review and ratify the minutes of the prior meeting and correct any misinterpretations of the events or actions of the committee at that meeting as reported in the minutes.	6
iii. It is recommended that the nominating and executive committees comply with the approved by-laws of the company and appoint three members to receive and vote the proxies of the Corporation members at the annual meeting of policyholders.	6
B. <u>Reinsurance</u>	
i. It is recommended that the Company comply with the terms of its inter-company pooling agreement and pool all accounts in accordance with that agreement.	10
ii. It is recommended that the Company include the required clauses in its reinsurance agreements.	12
iii. It is recommended that the Company establish a formal procedure for the documentation of contract reviews of reinsurance agreements.	13
iv. It is recommended that the Company comply with SSAP No. 63 financial statement disclosure requirements.	13
v. It is recommended that the Company retain all documentation pertaining to its review of its reinsurance contracts prior to execution.	14
C. <u>Affiliated Companies</u>	
i. It is recommended that the Company comply with Section 1608(b) of the New York Insurance Law and its inter-company service agreements with these two affiliates by charging each affiliated Company with the	17

<u>ITEM</u>	<u>PAGE NO.</u>
appropriate amount of the investment expenses for the services provided.	
ii. It is recommended that the Company comply with Department Circular Letter No. 33 (1979) and all amendments to its inter-company tax allocation agreements to the board of directors for approval and then to the Department for non-disapproval at least 30 days prior to the effective date of any changes to the agreement.	17
iii. It is recommended that the Company comply with its tax allocation agreement and settle its inter-company balances within 30 days of the filing of the applicable estimated or actual consolidated federal income tax return with the Internal Revenue Service.	18
iv. It is recommended that the Companies comply with Circular Letter No. 17 (2001) and report all transactions exceeding the benchmarks, on the required form, to this Department at least 30 days prior to entering into such transaction.	19
v. It is recommended that the Companies comply with the National Association of Insurance Commissioners' Annual Statement Instructions and properly report all sales and acquisitions of securities and the related investment gains and losses in all future statements filed with this Department.	19
D. <u>Accounts and Records</u>	
i. It is recommended that the Company comply with SSAP No. 6, paragraph 9 when determining its nonadmitted uncollected premiums and agents' balances.	21
ii. It is recommended that the Company comply with SSAP No. 4 by not reducing the non-admitted portion of its premium balances due by amounts in the control of others.	21
iii. It is recommended that the Company comply with Department Regulation 118 by entering into future contracts with its independent auditor that contains the requisite provisions.	22
iv. It is recommended that the Companies comply with Part 1 Section IV(J) of the NAIC Financial Condition Examiners Handbook by revising its custodial agreements to include all of the requisite safeguards and controls.	24

<u>ITEM</u>	<u>PAGE NO.</u>
v. It is further recommended that the Companies respond appropriately to the general interrogatories in all future statements filed with this Department.	24
vi. It is recommended that the Company exercise more care in the preparation of its filed statements and fully comply with the NAIC Annual Statement Instructions for all future statements filed with this Department.	24
vii. It is recommended that the Company institute a formal approval policy to document and control manual entries made to the Company's books and records.	25
viii. It is recommended that the Company institute the necessary internal controls to prevent possible defalcation of the bonds.	25
ix. It is recommended that the Company strengthen its controls of draft stock.	25
x. It is recommended that the Company count the drafts held at the agencies during the agency audit process.	25
xi. It is recommended that the Company require each agency to submit a list of authorized signatories.	26
xii. It is recommended that the Company perform the necessary "due diligence" on all banks, broker/dealers, servicing agents, property managers and others with whom the insurer has established a business relationship.  Subsequent to the examination date the Company severed its relationship with this investment manager.	26
xiii. It is recommended that the Company retain this report and any similar reports that capture the detail of the information keyed on a claim prior to its deletion.  Subsequent to the examination, the Company instituted a program to retain this information for the period required by Department Regulation 152.	27
xiv. It is recommended that the Company comply with Section 1302(b) of the New York Insurance Law and non-admit all assets of doubtful value.	27

<u>ITEM</u>	<u>PAGE NO.</u>
xv. It is recommended that the Company produce and maintain the records in the form and manner required by Department Regulation 30.	28
E. <u>Expense Limitation</u>	
It is recommended that the Company comply with the management expense limitations set forth in Section 4110 of the New York Insurance Law.	28
F. <u>Bonds</u>	
It is recommended that the Company amortize its bond assets in accordance with the NAIC's SSAP No. 26.	33
G. <u>Losses and Loss Adjustment Expenses</u>	
i. It is recommended that the Company ensure that the actuarial report is prepared in accordance with the NAIC Annual Statement Instructions and include all exhibits and documentation including a narrative to clearly explain the assumption and methodology used regarding the Adjusting and other expense reserve analysis.	36
ii. It is recommended that the Company's actuarial unit prepare and include in the actuarial report the requisite exhibits and documentation and provide the same to the examination in a timely manner.	36
iii. It is recommended that the Company comply with the NAIC Annual Statement Instructions and report all future changes of actuaries within the timeframe and in the manner prescribed by those instructions.	36
H. <u>Market Conduct</u>	
i. It is recommended that the Company revise its policy system to include the requisite wording of Department Regulation 90.	39
Subsequent to the examination date the Company revised its policy system to include the requisite wording.	
ii. It is recommended that the Company ensure that the current version of Department Regulation 64 is available to all persons administering claims settlement as required therein.	39
iii. It is recommended that the Company revise its complaint log to	40



<u>ITEM</u>		<u>PAGE NO.</u>
	incorporate the data with the requisite column headings as required by Circular Letter No. (1978).	
iv.	It is recommended that the Company generate quarterly reports and forward them to the heads of the respective operating units and to the Company president.	40
v.	In addition, it is recommended that management either generate separate logs for each Company or include an identifier of the Company in the Utica National Insurance Group that generated the complaint.	41
vi.	It is recommended that the Company update the settlement authority for claims to conform with its currently approved procedures.	41
vii.	It is recommended that the Company either comply with their written procedures or amend the procedures to conform to its current practice.	41



Appointment No 22354

STATE OF NEW YORK  
INSURANCE DEPARTMENT

I, HOWARD MILLS, Acting Superintendent of Insurance of the State of New York,  
pursuant to the provisions of the Insurance Law, do hereby appoint:

**Alfred Bloomer**

*as proper person to examine into the affairs of the*

**UTICA MUTUAL INSURANCE COMPANY**

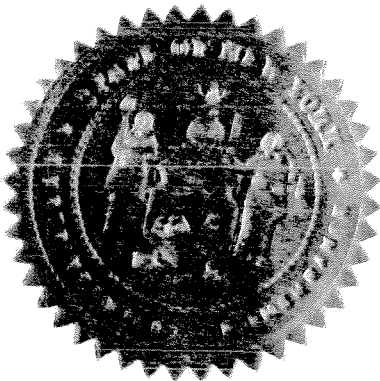
*and to make a report to me in writing of the condition of the said*

**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 1st day of April, 2005*



A handwritten signature in cursive script, appearing to read "Howard Mills".

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HOWARD MILLS  
Acting Superintendent of Insurance