

REPORT ON EXAMINATION

OF THE

EXCESS LINE ASSOCIATION OF NEW YORK

AS OF

DECEMBER 31, 2011

DATE OF REPORT

NOVEMBER 28, 2012

EXAMINER

SHAWN JERNIGAN

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NEW YORK STATE  
DEPARTMENT *of*  
FINANCIAL SERVICES

Andrew M. Cuomo  
Governor

Benjamin M. Lawsky  
Superintendent

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November 28, 2012

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 30860, dated June 13, 2012, attached hereto, I have made an examination into the condition and affairs of Excess Line Association of New York as of December 31, 2011, and submit the following report thereon.

Wherever the designations "the Association" or "ELANY" appears herein without qualification, it should be understood to indicate Excess Line Association of New York.

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 Association's home office located at One Exchange Plaza, 55 Broadway, 29<sup>th</sup> Floor, New York, New York 10006.

## **1. SCOPE OF EXAMINATION**

The Department has performed an individual examination of the Association. The previous examination was conducted as of December 31, 2007. This examination covered the four year period from January 1, 2008 through December 31, 2011. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination was conducted to ascertain the manner in which the Association conducts its business with regards to fulfilling its purpose as stated in Section 1 of Chapter 630 of the Laws of 1988; which is "... to facilitate and encourage compliance by its members (excess line brokers) with the laws of this state and the rules and regulations of the Superintendent relative to excess line insurance". The examination also reviewed the Association's performance with regards to carrying out its underlying purpose of 1) protecting persons seeking insurance in this state; 2) permitting excess line insurance to be placed with reputable and financially sound unauthorized insurers; and 3) protecting the revenues of this State.

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

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

## **2. OVERVIEW OF ELANY**

### **A. History**

ELANY was established as a non-profit association pursuant to Chapter 630 of the Laws of 1988 and began operation on January 1, 1989.

The operating procedures for the administration of ELANY are governed by a Plan of Operation (the "Plan") approved by the Superintendent pursuant to Section 2130(c) (1) of the New York Insurance Law.

B. Membership

All excess line brokers licensed under Section 2105 of the New York Insurance Law are deemed members of ELANY pursuant to Section 2130(a) of the Insurance Law. The membership ends with the termination of the broker's excess line license. When brokers become licensed as excess line brokers, the Licensing Bureau of the New York State Department of Financial Services notifies ELANY which in turn sends the new members an information package to assist them in performing their duties as excess line brokers.

**3. PLAN OF OPERATION REVIEW**

A. Management

Pursuant to the Association's Plan as approved by the Superintendent of Financial Services, management of the Association is vested in a board of directors, consisting of not less than five nor more than nine members. The board is required to meet four times during each calendar year. At December 31, 2011, the board of directors was comprised of the following nine members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Lance Becker Melville, NY	President Arthur J. Gallagher Risk Management Services, Inc.
John A. Buckley Lincroft, NJ	President NIF Services on New York, Inc.
Joseph F. Caligiuri Bright Waters, NY	President Lighthouse Specialty Brokers, Inc.
Thomas J. Deralla Kingston, NY	President The Kingstar Company Inc.
Gary A. Hollederer Grand Island, NY	Executive Vice President Russell Bond & Co., Inc.
David Isenberg New York, NY	President DC White Agency
Janet Pane Bayonne, NJ	Managing Director Willis North America, Inc.
Donald Privett New York, NY	President Privett Special Risk Services
Robert Shapiro Lynbrook, NY	President Global Facilities Inc.

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member has an acceptable record of attendance.

B. Administration

Pursuant to the Plan, the Executive Director shall be the chief operating officer of ELANY, who primary responsibility is to implement the policies of the Board of Directors. The Plan also provides that ELANY may employ such persons, firms, or corporations, attorneys or accountants, as are necessary for the performance of the duties imposed on ELANY.

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

<u>Name</u>	<u>Title</u>
Thomas J. Deralla	Chairman
Joseph F. Caligiuri	Vice-Chairman
Gary A. Hollederer	Treasurer
John A. Buckley	Secretary
Daniel F. Maher	Executive Director

#### **4. FINANCIAL STATEMENTS**

The financial statements consist of a balance sheet reflecting the assets and liabilities as of December 31, 2011, and a statement of income for the period January 1, 2007 through December 31, 2011.

ELANY's financial statements were audited by a firm of certified public accountants. An unqualified opinion was rendered for every year of the examination period.

## 5. ELANY FUNCTIONS

### A. Processing and Stamping of Affidavits

Pursuant to Section 2118(b) (1) of the New York Insurance Law, within 45 days after an excess line policy is procured, member brokers are required to submit to ELANY affidavits along with the policy declaration page or cover note evidencing placements with unauthorized insurers. These documents are then reviewed by ELANY examiners for completeness and accuracy. If the submitted affidavit is not prepared properly or contains questionable information, the documents evidencing placement are returned unstamped to the broker for correction and/or additional explanation. Otherwise, the placement is recorded into ELANY's database and the policy declarations page or cover note is stamped and returned to the broker. The affidavits are also submitted to the Department in accordance with Section 2130(a) (4) of the New York Insurance Law. The member broker is then billed .2% of the reported premium for this stamping.

ELANY members submit the affidavits and policy endorsements in groupings referred to as batches. An affidavit review was conducted to ascertain if ELANY members were filing such in a timely manner pursuant to the provisions of Section 2118 (b) (1) of the New York Insurance Law and the adherence to the requirements of Department Regulation No. 41. The review was confined to the 2010 and 2011 calendar years, which 60 batches were reviewed for each year and is detailed below:

#### 1. Late Submissions

The following table contains a breakdown of the findings of the affidavit review:

	<u>Batch</u> <u>Populations</u>	<u>Batches</u> <u>Reviewed</u>	<u>Total</u> <u>Affidavits</u> <u>Reviewed</u>	<u>Late</u> <u>Affidavits</u>	<u>Percentage</u>
2010	105,687	60	59	2	5%
2011	<u>109,641</u>	<u>60</u>	<u>109</u>	<u>6</u>	<u>6%</u>
Totals	215,328	120	168	8	5%

The percentages of late submissions above remain virtually unchanged from the five percent average from the prior report on examination.

## 2. Declination Procedures

Unless a particular coverage is listed on the export list, an excess line broker is required to obtain three declinations from licensed insurers prior to the placement of a risk in the excess line market. A review of the declination information was included in the affidavit review. The review of the declinations was to ascertain whether the notice of excess line placement dates preceded the declination dates. Declinations were also reviewed to verify that they were received from authorized insurance companies.

The following table is the breakdown of the finding of the declination review:

<u>Year</u>	<u>Total Affidavits Reviewed</u>	<u>Placement Date Precedes Declination Date</u>	<u>Percentage</u>	<u>Number of Times Placement Date Not Available</u>	<u>Percentage</u>
2010	59	5	8%	22	37%
2011	<u>109</u>	<u>6</u>	<u>6%</u>	<u>48</u>	<u>44%</u>
Totals	168	11	7%	70	42%

It should be noted that affidavit submissions with no placement dates do not allow examiners to make a determination as to whether the excess line placement was made before the declinations were obtained.

In 2008, ELANY implemented an electronic database system, which enables brokers to submit transactions electronically. According to the Association, this system has built-in business rules that must be met and all pertinent sections of the affidavit must be completed. ELANY reviews the brokers' submissions for completeness and accuracy. If errors are noted, corrections are made based on communications with the broker or corrected documents are resubmitted by the broker.

ELANY stated that by allowing the brokers to file their affidavits electronically, the number of errors should be greatly reduced. However, based on our review above, 7% of the total affidavits reviewed had placement dates that preceded the declination dates and 42% were submitted with no placement dates. In addition, it was noted that the percentage of instances in which the placement date precedes the declination date and in which no placement date was available increased significantly from the percentages indicated in the prior report on examination; thereby suggesting a continuing trend.



As recommended in the prior report on examination, a spot audit function was to be established to verify the Association's "Declination Procedures", which includes ascertaining whether the declination dates preceded the inception dates of the policies. Results of these audits are to be sent to the Department's Excess Line Unit. A preliminary result of this audit for the year 2012 indicates an error rate of approximately 2%.

It is recommended that ELANY incorporate within the built-in business rules of their electronic database system, criteria in which affidavits are red-flagged when the placement date precede the declination date.

It is recommended that ELANY continue to monitor the submission of the notice of the excess line placement form to ensure that the proper procedures with regards to declinations and the placement of coverage are adhered to in accordance with the New York Insurance Law and Department Regulation No. 41.

It is recommended that ELANY continue to verify the Association's "Declination Procedures", which includes ascertaining whether the notice of excess line placement/inception dates preceded declination dates, by conducting spot check audits and report the results of these audits to the Department's Excess Line Unit.

**B. Unauthorized Insurer Files**

As part of the application process to be accepted as an eligible unauthorized insurer in New York, ELANY requires an unauthorized insurer intending to do business in New York to submit financial statements and other pertinent documentation for analysis and evaluation in accordance with Section 27.13 of Department Regulation No. 41. If ELANY determines that the insurer qualifies for eligibility, ELANY notifies the insurer in writing of its acceptance and places the insurer on ELANY's stamping list of eligible insurers. Once on the stamping list, eligible insurers are monitored for financial strength and viability and are subject to an annual re-qualification process.

However, if ELANY determines that an insurer does not qualify for eligibility, the insurer is notified of the said ineligibility. The insurer can later submit updated financial information and documentation to ELANY for its reconsideration.

A review of the unauthorized insurers' application files was conducted to determine whether ELANY has fulfilled its statutory obligations of admitting unauthorized insurers who are financially sound and has treated applicants fairly and equally. Through a review of the Board of Directors minutes, a listing was made of all companies which applied for the stamping list during the examination period. A sample of companies, which were either approved or rejected, was reviewed. It was determined that documentation was adequate; the files contained supporting evidence that an analysis of the financial information had been performed and that the review performed by ELANY on the submitted information was done consistently and fairly.

C. Expenditures

a) Charitable and Non-charitable Contributions

On July 15, 2009, the Office of General Counsel ("OGC") issued an opinion which modifies their previous opinion of June 7, 2007, which discussed the permissibility of ELANY making *de minimis* charitable contributions. The opinion states that in the Department's estimation, Section 2130 of the Insurance Law, which created ELANY as a quasi-public entity, fails to provide ELANY with sufficient authority to make any contributions, except that in certain narrow parameters, *de minimis* charitable contributions may be considered to be "incidental or related" to ELANY's purposes. OGC therefore concluded that:

- (1) ELANY may make no charitable contributions whatsoever, except to an organization providing humanitarian aid in the wake of a natural disaster or terrorist act, or to an organization established by the insurance industry for charitable works;
- (2) ELANY must limit its total contributions to any given charitable organization to \$15,000 in any calendar year;
- (3) ELANY must limit its aggregate charitable contributions to \$50,000 in any calendar year;
- (4) ELANY must itemize each charitable contribution it made during the year under review in the annual audited statement that ELANY files with the Department, and specify the organization to whom the contribution was made, the date of the contribution, the amount of the contribution, and that nature and purpose of the gift; and
- (5) ELANY must ensure that its Board approves each donation, no matter the amount.

The Department had no objections to these modifications based on the representations from ELANY that (1) ELANY does not expect to make contributions totaling \$50,000 in any given year except in “extraordinary circumstances”, and (2) that \$50,000 represents less than 1% of ELANY’s total annual revenues. In addition, ELANY must strictly adhere to the parameters of the June 7<sup>th</sup>, 2007 opinion in all other respects. Based on our review of ELANY’s charitable and non-charitable contributions, it appears that ELANY was in compliance with the parameters as set forth in the OGC opinion dated June 7, 2007 and modified on July 15, 2009 for the years covered by this examination period.

b) Travel & Entertainment Guidelines

As part of the expenditures review, expenses which pertained to payment for travel and entertainment expenses of ELANY personnel were reviewed to verify that ELANY’s payment of these expenses were in accordance with Association guidelines. In accordance with the Travel and Entertainment Policy of ELANY, only expenses which are reasonable and necessary for the conduct of the Association’s business are to be charged and reimbursed by ELANY. In addition, with regard to spousal/family travel, travel costs for family members other than the spouse are not reimbursable, with the exception of any Board meeting or series of Board and Committee meetings held over a multiple day period away from ELANY’s offices.

With regard to multiple day board of directors meetings, as noted in the previous report and indicated in previous correspondence from ELANY, it is their procedure that each Board member is extended a budget of \$500 to use at their discretion to defray additional charges for use of various facilities and services charged by hotels/resorts for each Board member, his/her spouse and family (non adult children) while attending these meetings.

As per the recommendation from the previous report, the Association was to update their written Travel & Entertainment guidelines to clarify any exceptions to the guidelines in place, including the discretionary budget inclusive of family members. The guidelines were updated; however, the preset approved limit of \$500 was not made a part of the guidelines.

In reviewing the expenses presented for approval relating to ELANY’s August 2011 Board of Directors meeting, it appeared that charges in excess of \$500 were approved for Board Members, which is not in compliance with the Association’s Travel and Entertainment guidelines.

It is recommended that ELANY adhere to its Travel & Entertainment guidelines and to update the written policy to include a preset approved limit for additional Board Member, spousal and non adult family member discretionary charges for multi day Board Meetings.

D. Statement of Fund Balance/Stamping Fee

The fund balance decreased \$2,333,881 during the four-year examination period (January 1, 2008, through December 31, 2011) and is detailed below:

	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>
Beginning Fund Balance	\$21,593,346	\$21,556,756	\$20,004,964	\$19,567,895
Total Revenues	\$5,844,986	\$4,277,250	\$5,103,680	\$5,265,938
Total Expenses	\$5,881,576	\$5,829,042	\$5,540,749	\$5,574,368
Excess of Revenues over Expenses	(\$36,590)	(\$1,551,792)	(\$437,069)	(\$308,430)
Ending Fund Balance	\$21,556,756	\$20,004,964	\$19,567,895	\$19,259,465

The decrease was primarily due to the severe economic downturn of 2009, and increased depreciation allowance for the Association's ELANY Back Office electronic system. The fund balance of \$19,259,465 continues to exceed the current operational needs of ELANY.

It is recommended the Board of Directors of ELANY continue to monitor the fund balance in order to assure that the accumulated fund balance will be able to satisfy the reasonable operational needs of ELANY.

E. Internal Controls

As part of the examination, the internal control procedures of ELANY were reviewed. The review revealed weaknesses in the internal controls specifically relating to segregation of duties. This is common in small organizations that do not have enough available staff where each individual is responsible for separate responsibilities relative to processing and recording of financial information.

The Association has instituted additional control measures to mitigate the risk present because of the above mentioned internal control weakness. The Association's procedures were tested to determine if all control measures put in place were done as ELANY indicated, as well as cursory tests to determine if there were any abnormalities present with regards to obligations and liabilities being properly authorized and recorded. The procedures in place were in fact performed by the Association and no abnormalities were discovered.

## 6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained nine recommendations as follows (item letters and page numbers refer to that of the prior report):

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A. It is recommended that ELANY monitor the submission of the notice of the excess line placement form to insure that the proper procedures with regard to declinations and the placement of coverage are adhered to in accordance with the New York Insurance Law and Regulation 41.</p> <p>The Association has not complied with this recommendation. A similar comment is made in this report.</p>	7
<p>B. It is recommended that ELANY contact those members who submit questionable and incomplete affidavits and provide them with appropriate training.</p> <p>The Association has complied with this recommendation.</p>	7
<p>C. It is recommended that ELANY contact those members who submit affidavits/notice of excess line placement forms where the notice of excess line placement date or inception date precedes the declination date and provide those members with appropriate training.</p> <p>The Association has complied with this recommendation.</p>	7
<p>D. It is recommended that ELANY verify the Association's "Declination Procedures", which includes ascertaining whether the notice of excess line placement/inception dates preceded declination dates by conducting spot check audits and report the results of these audits to the Department's Excess Line Unit.</p> <p>The Association has not complied with this recommendation. A similar comment is made in this report.</p>	7
<p>E. It is recommended that going forward, ELANY adhere to the parameters set forth in the OGC opinion dated June 7, 2007 concerning charitable contributions.</p> <p>The Association has complied with this recommendation.</p>	9
<p>F. It is recommended the Board of Directors of ELANY continue to monitor the fund balance in order to assure that the accumulated fund balance will be able to satisfy the reasonable operational needs of ELANY.</p> <p>The Association has complied with this recommendation.</p>	10

<u>ITEM</u>		<u>PAGE NO.</u>
G.	It is recommended that ELANY incorporate the principle of segregation of duties in order to ensure that ELANY's assets are safeguarded and its obligations and liabilities are properly authorized and recorded.	11
	The Association has complied with this recommendation.	
H.	It is recommended that ELANY properly approve all authorizations for expenses.	11
	The Association has complied with this recommendation.	
I.	It is recommended that ELANY adhere to its Travel & Entertainment guidelines and to update the written policy to clarify any exceptions to the present guidelines.	12
	The Association has not complied with this recommendation. A similar comment is made in this report.	

7. **SUMMARY OF COMMENTS AND RECOMMENDATIONS**

<u>ITEM</u>	<u>PAGE NO.</u>
A. It is recommended that ELANY incorporate within the built-in business rules of their electronic database system, criteria in which affidavits are red-flagged when the placement date precedes the declination date.	7
B. It is recommended that ELANY continue to monitor the submission of the notice of the excess line placement form to ensure that the proper procedures regarding declinations and the placement of coverage are adhered to in accordance with the New York Insurance Law and Department Regulation No. 41.	7
C. It is recommended that ELANY continue to verify the Association's "Declination Procedures", which includes ascertaining whether the notice of excess line placement/inception dates preceded declination dates, by conducting spot check audits and report the results of these audits to the Department's Excess Line Unit.	7
D. It is recommended that ELANY adhere to its Travel & Entertainment guidelines and to update the written policy to include a preset approved limit for additional Board Member, spousal and non adult family member discretionary charges for multi day Board Meetings.	10
E. It is recommended the Board of Directors of ELANY continue to monitor the fund balance in order to assure that the accumulated fund balance will be able to satisfy the reasonable operational needs of ELANY	10



Respectfully submitted,

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Shawn Jernigan  
Senior Insurance Examiner

STATE OF NEW YORK    )  
                                  ) ss.  
COUNTY OF NASSAU    )

SHAWN JERNIGAN, being duly sworn, deposes and says that the foregoing report submitted by him is true to the best of his knowledge and belief.

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Shawn Jernigan

Subscribed and sworn to before me  
this \_\_\_\_\_ day of \_\_\_\_\_ 2014.

*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:*

***Shawn Jernigan***

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

***EXCESS LINE ASSOCIATION OF NEW YORK***

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

***ASSOCIATION***

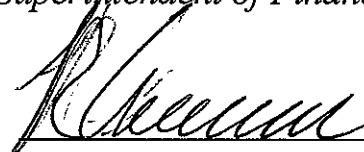
*with such other information as he shall deem requisite.*

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

*this 13th day of June, 2012*

*BENJAMIN M. LAWSKY  
Superintendent of Financial Services*

*By:*



*Rolf Kaumann  
Deputy Chief Examiner*

