

REPORT ON EXAMINATION

OF THE

PROVIDENCE WASHINGTON INSURANCE COMPANY OF NEW YORK

AS OF

DECEMBER 31, 2002

DATE OF REPORT

APRIL 15, 2004

EXAMINER

JOHN TUDINO JR., CFE, CIE, CFSA

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

April 15, 2004

Honorable Gregory V. Serio  
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 22074 dated June 30, 2003 attached hereto, I have made an examination into the condition and affairs of Providence Washington Insurance Company of New York as of December 31, 2002, and submit the following report thereon.

The examination was conducted at the Company's home office located at One Providence Washington Plaza, Providence, Rhode Island 02903.

Wherever the designations "the Company" or "PWNKY" appear herein without qualification, they should be understood to indicate Providence Washington Insurance Company of New York.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York Insurance Department.

This examination has determined that the Company's required to be maintained minimum surplus to policyholders of \$4,200,000 is impaired in the amount of \$274,838.

Subsequent to the date of this examination, the Company received a surplus contribution of \$3,000,000, thereby eliminating the impairment.

## 1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1998. This examination covered the four-year period from January 1, 1999 through December 31, 2002. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination comprised a complete verification of assets and liabilities as of December 31, 2002. The examination included a review of income, disbursements and Company records deemed necessary to accomplish such analysis or verification and utilized, to the extent considered appropriate, work performed by the Company's independent public accountants. 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:

- 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
- Reinsurance
- Accounts and records
- Financial statements

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

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

## 2. **DESCRIPTION OF COMPANY**

The Company was incorporated as a stock insurance company on January 3, 1978 as the Baloise Insurance Company of America. It was licensed by the New York State Insurance Department (NYSID) on January 31, 1978 and commenced business on the same day.

Upon its incorporation, the Baloise Insurance Company of America was a controlled insurer of Baloise-Holding Co., (“Baloise-Holding”) the ultimate holding company. Pursuant to consent granted by the Department dated November 29, 1994, ownership of the Baloise Insurance Company of America was transferred from the Baloise Insurance Company Limited to Baloise-Holding. On December 31, 1994 Baloise-Holding contributed all outstanding stock to Baloise U.S. Holdings, Inc. and Baloise U.S. Holdings, Inc. contributed all outstanding stock to PW Holdings, Inc. On October 23, 1998, control of the Baloise Insurance Company of America was transferred in a transaction approved by the Department by order dated October 20, 1998, pursuant to which all the outstanding shares of the voting securities of Baloise U.S. Holdings, Inc. (parent of PW Holdings, Inc.) were sold to PW Acquisition Co. Control of PW Acquisition Co. is maintained by Securitas Partners, Inc., a global investment firm based in New York. Ninety-one percent (91%) of the voting securities of Securitas Partners, Inc. is held by a voting trust.

Effective January 26, 1999, the name of the Company was changed to Providence Washington Insurance Company of New York.

Capital paid in is \$3,000,000 consisting of 20,000 shares of common stock at \$150 par value per share. Gross paid in and contributed surplus is \$2,500,000. There has been no change in the capital structure of the Company since the prior examination conducted as of December 31, 1998.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than thirteen nor more than twenty-one members. The board met at least four times during each calendar year. At December 31, 2002, the board of directors was comprised of the following thirteen members:

| <u>Name and Residence</u>                | <u>Principal Business Affiliation</u>  |
|--|--|
| Robert B. Carlson<br>East Greenwich, RI  | Vice President, Policyholder Services<br>Providence Washington Insurance Company   |
| Richard A. D'Alfonso<br>Saunderstown, RI | Vice President, Commercial Lines<br>Providence Washington Insurance Company  |
| Mary Clare Decker<br>Chestnut Hill, MA   | Vice President, Corporate Secretary and General<br>Counsel,<br>Providence Washington Insurance Company                     |
| Jan H. Dunn<br>Wayland, MA               | Vice President, Human Resources<br>Providence Washington Insurance Company   |
| Gayle E. Haskell<br>East Greenwich, RI   | Senior Vice President, Chief Financial Officer,<br>Treasurer and Chief Actuary,<br>Providence Washington Insurance Company |
| Marcia S. Hirsch<br>Huntington, NY       | Claims Supervisor,<br>Providence Washington Insurance Company  |
| Richard J. Hoag<br>East Greenwich, RI    | President and Chief Executive Officer,<br>Providence Washington Insurance Company  |
| Laura M. Hughes<br>Wantagh, NY           | Senior Claims Manager,<br>Providence Washington Insurance Company  |

| <u>Name and Residence</u>               | <u>Principal Business Affiliation</u>   |
|---|---|
| Edward N. Leveille<br>Providence, RI    | Vice President, Systems,<br>Providence Washington Insurance Company                               |
| Steven A. McGrath<br>Attleboro, MA      | Vice President, Agency Development<br>Providence Washington Insurance Company                     |
| Susan Mischner<br>Bayside, NY           | Senior Claims Supervisor,<br>Providence Washington Insurance Company                              |
| Reginald B. Stith<br>East Greenwich, RI | Senior Vice President, Operations<br>Providence Washington Insurance Company                      |
| Donald E. Woellner<br>Cranston, RI      | Vice President, Controller and Assistant<br>Treasurer,<br>Providence Washington Insurance Company |

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member had an acceptable record of attendance with the exception of Donald Woellner, Laura Hughes and Gayle Haskell, each of whom attended 50% or less of the meetings for which they were eligible to attend in 1999, 2001 and 2002, respectively. In addition, two former members of the board of directors who served during the period under examination did not attend 50% of meetings they were eligible to attend in 1999.

Members of the board of directors have a fiduciary responsibility and must evince an ongoing interest in the affairs of the insurer. It is essential that board members attend meetings consistently and set forth their views on relevant matters so that the board may reach appropriate decisions. Individuals who fail to attend at least one-half of the regular meetings do not fulfill such criteria.

It is again recommended that board members who are unable or unwilling to attend meetings consistently, resign or be replaced.

As of December 31, 2002, the principal officers of the Company were as follows:

| <u>Name</u>          | <u>Title</u>   |
|----------------------|--|
| Richard J. Hoag      | President and Chief Executive Officer  |
| Robert B. Carlson    | Senior Vice President, Claims  |
| Richard A. D'Alfonso | Vice President, Commercial Lines   |
| Mary Clare Decker    | Vice President, General Counsel and<br>Corporate Secretary                     |
| Jan H. Dunn          | Vice President, Human Resources  |
| Gayle E. Haskell     | Senior Vice President, Chief Financial<br>Officer, Treasurer and Chief Actuary |
| Reginald B. Stith    | Senior Vice President, Field Operations  |
| Donald E. Woellner   | Vice President, Financial Reporting and<br>Assistant Treasurer                 |

It should be noted that during the period subsequent to the examination date, the Company experienced significant turnover in its senior management. These changes are summarized below:

- Richard A. D'Alfonso – Resigned as Vice President, Commercial Lines, effective April 11, 2003.
- Gayle E. Haskell – Resigned as Senior Vice President, CFO, Treasurer and Chief Actuary, effective August 29, 2003.
- Robert B. Carlson – Appointed Senior Vice President, CFO and Treasurer, effective August 29, 2003
- Richard J. Hoag – Resigned as Chairman, President and Chief Executive Officer, effective September 9, 2003.
- John F. Shettle, Jr. – Appointed Chairman, President and Chief Executive Officer, effective September 9, 2003.

B. Territory and Plan of Operation

As of December 31, 2002, the Company was licensed to write business in the sixteen states listed below:

|             |              |
|-------------|--------------|
| Connecticut | New Jersey   |
| Delaware    | New York     |
| Georgia     | Ohio         |
| Illinois    | Pennsylvania |

Louisiana  
 Maryland  
 Massachusetts  
 Michigan

Rhode Island  
 Texas  
 Virginia  
 Washington

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 damage                     |
| 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               | Workers' compensation and<br>employers' liability |
| 16               | Fidelity and surety                               |
| 17               | Credit  |
| 19               | Motor vehicle and aircraft physical<br>damage     |
| 20               | Marine and inland marine                          |
| 21               | Marine protection and indemnity                   |
| 22               | Residual value                                    |

In addition, the Company is licensed to transact such workers' compensation as may be incident to coverages relating to ocean marine contemplated under paragraphs 20 and 21 of Section 1113(a), including insurances described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69<sup>th</sup> Cong. as amended; 33 USC Section 901 et seq. as amended).

Based on the lines of business for which the Company is licensed and the Company's current capital structure, and pursuant to the requirements of Articles 13 and 41 of the New York Insurance Law, the Company is required to maintain a minimum capital of \$500,000 and surplus to policyholders in the amount of \$4,200,000.

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

DIRECT PREMIUMS WRITTEN

| <u>Calendar<br/>Year</u> | <u>New York State</u> | <u>Total United States</u> | <u>Premiums Written in New<br/>York as a % of Total</u> |
|--------------------------|-----------------------|----------------------------|---|
| 1999                     | \$10,040,236          | \$15,371,977               | 65.3%   |
| 2000                     | 16,581,438            | 26,056,134                 | 63.6  |
| 2001                     | 19,409,357            | 31,783,735                 | 61.1  |
| 2002                     | <u>15,348,603</u>     | <u>25,902,745</u>          | <u>59.3</u>   |
| Total                    | <u>\$61,379,634</u>   | <u>\$99,114,591</u>        | <u>61.9%</u>  |

The Company can be characterized as a multi-regional insurer. Management considers PWNKY as the most selective underwriting company in the Providence Washington Insurance Group and correspondingly has the lowest priced product. The Company's premium volume is heavily oriented toward the northeast. New York continues to be the Company's largest state by a significant margin. After the northeast, the mid-atlantic territories, specifically Pennsylvania and New Jersey, represent the next largest underwriting territory.

The Company's focus is on independent agents as its sole distribution channel. With this focus, the Company has moved away from its joint venture strategy of the late 1980's and early 1990's. It maintains a significant relationship with one particular independent agency, which functions as a

managing general agent (“MGA”) on behalf of the Company. This agency, the Treiber Agency Group, LLC (“Treiber”) of Long Island, New York, produced approximately 34% of the Company’s direct premiums written in 2002.

The Company continues to offer a broad range of personal and commercial property and casualty products. Its focus has been to operate in the smaller commercial accounts with low to moderate hazard size grades. It also offers personal lines products on a selective basis. Finally, over the course of the past two years, the Company has withdrawn from the somewhat more hazardous programs; trucks, tow-truck operators and new car dealers, and focused its target marketing on the low to moderate hazard grades which fit its strategic capabilities.

### C. Reinsurance

#### Assumed

Reinsurance assumed by the Company is minimal and is comprised of one voluntary pool in which the Company’s participation was cancelled on June 5, 1998. The business relating to this pool is currently in run-off status.

#### Intercompany Pooling Agreement

Effective January 1, 1995, the Company became a party to a quota share reinsurance treaty pooling agreement with its affiliated insurers, Providence Washington Insurance Company (“PWIC”), York Insurance Company (“YORK”) and American Concept Insurance Company (“ACIC”), collectively known as the Providence Washington Insurance Companies. Pursuant to the terms of the pooling agreement, each participant cedes 100% of its gross exposure to the lead pool member, PWIC; a Rhode Island domiciled insurer. The lead pool member, in turn, cedes all outside reinsurance and

retrocedes to each pool member its pro-rata share of the net pooled business. At December 31, 2002, the Company's quota share of the pool was eight percent.

Pursuant to Article VIII of the pooling agreement, all intercompany balances are to be settled within 45 days of the close of each calendar quarter. However, during the current examination, it was noted that not all balances were being settled within the 45 days as required under the pooling agreement. It is recommended that the Company comply with Article VIII of the pooling agreement by settling all intercompany balances within 45 days of the close of each calendar quarter.

### Ceded

At December 31, 2002, Providence Washington Insurance Company maintained the following ceded reinsurance program on behalf of the Providence Washington Insurance Companies:

| <u>Type of Contract</u>   | <u>Coverage</u>   |
|---|---|
| <u>First Property Per Risk Excess of Loss</u><br>100% Authorized                            | \$500,000 any one risk and \$1,500,000 all risks any one loss occurrence. Net retention of \$500,000.     |
| <u>Second Property Per Risk Excess of Loss</u><br>100% Authorized                           | \$2,000,000 any one risk and \$4,000,000 all risks any one loss occurrence. Net retention of \$1,000,000. |
| <u>Third Property Per Risk Excess of Loss</u><br>100% Authorized                            | \$3,000,000 any one risk and \$6,000,000 all risks any one loss occurrence. Net retention of \$3,000,000. |
| <u>First Property Catastrophe Excess of Loss</u><br>64.5% Authorized<br>35.5% Unauthorized  | 95% of \$3,000,000 ultimate net loss excess of \$2,000,000.   |
| <u>Second Property Catastrophe Excess of Loss</u><br>62.5% Authorized<br>37.5% Unauthorized | 95% of \$5,000,000 ultimate net loss excess of \$5,000,000.   |
| <u>Third Property Catastrophe Excess of Loss</u><br>71.5% Authorized<br>28.5% Unauthorized  | 95% of \$10,000,000 ultimate net loss excess of \$10,000,000.   |

| <u>Type of Contract</u>   | <u>Coverage</u>   |
|---|---|
| <u>Fourth Property Catastrophe Excess of Loss</u><br>66.5% Authorized<br>33.5% Unauthorized | 95% of \$30,000,000 ultimate net loss excess of \$20,000,000.   |
| <u>Fifth Property Catastrophe Excess of Loss</u><br>60.0% Authorized<br>40.0% Unauthorized  | 95% of \$10,000,000 ultimate net loss excess of \$50,000,000.   |
| <u>First Casualty Excess of Loss</u><br>100% Authorized                                     | \$250,000 excess of \$750,000 each and every occurrence.  |
| <u>Second Casualty Excess of Loss</u><br>100% Authorized                                    | \$1,000,000 excess of \$1,000,000 each and every occurrence.  |
| <u>Third Casualty Excess of Loss</u><br>100% Authorized                                     | \$3,000,000 excess of \$2,000,000 each and every occurrence.  |
| <u>Fourth Casualty Excess of Loss</u><br>Includes Workers' Compensation<br>100% Authorized  | \$5,000,000 excess of \$5,000,000 each and every occurrence.  |
| <u>Workers' Compensation Excess of Loss</u><br>100% Authorized                              | \$10,000,000 ultimate net loss each occurrence in excess \$10,000,000 any one occurrence, subject to a maximum loss any one life of \$500,000.  |
| <u>Commercial and Personal Umbrella Liability Program</u><br>100% Authorized                |   |
| Commercial Risks:   | <u>First Layer:</u> 90% quota share of the first \$1,000,000.<br><u>Second Layer:</u> 100% of \$1,000,000 in excess of \$1,000,000, subject to a maximum of \$10,000,000.             |
| Personal Risks:   | <u>First Layer:</u> 90% quota share of the first \$1,000,000.<br><u>Second Layer:</u> 100% of \$1,000,000 in excess of \$1,000,000, subject to a maximum of \$5,000,000.              |
| <u>Commercial Umbrella Liability Quota Share Program</u><br>100% Authorized                 | <u>First Layer:</u> 75% quota share of the first \$1,000,000 each occurrence.<br><u>Second Layer:</u> 100% quota share in excess of \$1,000,000 subject to a maximum of \$10,000,000. |
| <u>Boiler and Machinery</u><br>100% Authorized  | 100% of the Company's net retained liability on Auto Center Program policies up to a maximum liability of \$25,000,000 any one risk.  |

Canadian Marine Cargo Excess of Loss  
86.47% Authorized  
13.53% Unauthorized

First Layer: 100% of CAN \$1,600,000 each and every occurrence in excess of CAN \$400,000 each and every occurrence.

Second Layer: 100% of CAN \$8,000,000 each and every occurrence in excess of CAN \$2,000,000 each and every occurrence.

Quota Share Reinsurance Program  
100% Unauthorized

Quota share covering 43.25% of all net business, excluding Commercial Automobile, in force as of December 1, 2001. Excludes all new and renewal business.

Adverse Loss Development Reinsurance Agreement  
100% Unauthorized

Up to \$26,000,000 on occurrences on or prior to December 31, 1997 arising on amounts payable on or after January 1, 1998, in excess of \$226,116,000 all losses combined.

Aggregate Excess of Loss Agreement  
100% Unauthorized

100% coverage for adverse loss and loss adjustment expense development up to \$20,000,000 in excess of retention of \$115,715,000.

### Retroactive Reinsurance

On December 17, 1993, the Company and its affiliates entered into an aggregate excess of loss agreement with an alien insurer. The agreement provides for 100% coverage for adverse loss and loss adjustment expense development up to \$20,000,000. The Providence Washington Insurance Companies' retention was \$115,715,000 and consideration paid was \$5,750,000. As required under Department Regulation 108, the Company properly recorded its share of the retroactive reinsurance ceded in the amount of \$1,600,000 (8% of \$20,000,000) as a contra-liability on the balance sheet.

Effective October 23, 1998, the Company and its affiliates entered into an adverse loss development reinsurance agreement with an alien insurer. The agreement provides for a maximum limit of liability in the amount of \$26,000,000 in excess of \$226,116,000 and covers occurrences on or prior to December 31, 1997 arising out of amounts payable on or subsequent to January 1, 1998. The

Company recorded its share of the retroactive reinsurance ceded in the amount of \$2,080,000 (8% of \$26,000,000) as a contra-liability on the balance sheet in accordance with Department Regulation 108.

D. Holding Company System

The Company is a member of the Providence Washington Insurance Companies. All outstanding shares of the Company are owned or controlled by PW Holdings, Inc., an insurance holding company domiciled in the State of Delaware. The ultimate controlling party in the holding company system is a voting trust.

A review of the holding company registration statements filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

The following is a chart of the holding company system at December 31, 2002:

\* Not an insurance company

At December 31, 2002, the Company was party to the following agreements with other members of its holding company system:

Financial Advisory Agreement

Effective October 23, 1998, the Company became a party to a financial advisory agreement (“Agreement”) with Securitas Capital, LLC (“Securitas”), a Delaware limited liability company, and PWIC (PWNY, collectively with Securitas, the “Companies”). Under the terms of the agreement, Securitas provides general management advisory services to the companies at a cost of no greater than \$500,000 per year. All services provided to the companies under the agreement are to be based upon the written criteria, standards and guidelines of the companies. During the examination it was determined that no such written criteria, standards and guidelines exist, because no management fees have been paid to Securitas under the agreement. It is recommended that the parties to the financial advisory agreement define the services to be provided by finalizing the written criteria, standards and guidelines to which the services are to be based, regardless if any management fees were incurred.

Tax Sharing Agreement

Effective October 23, 1998, the Company became a party to a tax sharing agreement with several of its insurer and non-insurer affiliates. On September 22, 1999, the agreement was amended to incorporate the Company’s name change as well as to modify the agreement to include the method of allocation for alternative minimum taxes.

Both of the above referenced agreements were found to have been filed with the New York Insurance Department pursuant to Section 1505 of the New York Insurance Law.

During 2001 and 2002, the Company paid cash dividends to its sole stockholder, PW Holdings, Inc., in the amount of \$920,000 and \$1,000,000, respectively.

E. Abandoned Property Law

Section 1316 of the New York 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 under examination were reviewed to ascertain compliance with the filing requirements of Section 1316 of the New York Abandoned Property Law. It was noted that in certain instances, both the preliminary report due annually on April 1st, and the final report due by September 10<sup>th</sup>, were not submitted until after the due dates.

It is recommended that the Company file its abandoned property reports on a timely basis pursuant to the provisions of Section 1316 of the New York Abandoned Property Law.

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 2002, based upon the results of this examination:

|  |           |
|--|-----------|
| Net premiums written in 2002 to surplus as regards policyholders                       | 3.28 to 1 |
| Liabilities to liquid assets (cash and invested assets less investments in affiliates) | 94.8%     |
| Premiums in course of collection to surplus as regards policyholders                   | 21.0%     |

Based upon the Company's 2002 annual statement filing, all of the above ratios fell within the benchmark ranges set forth in the Insurance Regulatory Information System ("IRIS") of the National Association of Insurance Commissioners. However, as a result of this examination, the net premiums written to policyholder surplus ratio exceeds the 3 to 1 benchmark and consequently, is now considered an "unusual value" under the IRIS system, due to examination increase to loss reserves and the provision for reinsurance.

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

|   | <u>Amounts</u>      | <u>Ratios</u>  |
|---|---------------------|----------------|
| Losses incurred                                 | \$40,929,853        | 71.23%         |
| Loss adjustment expenses incurred               | 9,694,568           | 16.87          |
| Other underwriting expenses incurred            | 18,295,798          | 31.84          |
| Aggregate write-ins for underwriting deductions | 2,638               | 0.01           |
| Net underwriting gain (loss)                    | <u>(11,464,284)</u> | <u>(19.95)</u> |
| Premiums earned                                 | <u>\$57,458,573</u> | <u>100.00%</u> |

G. Accounts and Records

During the period under examination, it was noted that the Company's treatment of certain items was not in accordance with generally accepted statutory accounting principles and/or Department guidelines. Descriptions of such items follow:

Internal Controls - EDP Systems

A review of the Company's information system controls revealed weaknesses in the area of business contingency planning ("BCP"). A summary of the concerns/exceptions noted follows:

- There is very little documentation to support a business impact analysis.
- There is no departmental restoration priorities.

- There are no procedures on how the restoration to normal operations at the home locations will occur.
- While there is a contact for an office supplier, there is no documentation as to what supplies would be needed in the event of a disaster.
- The plan does not contain a list of the application programs, operating systems, or data files that need to be recovered.
- The BCP has not been tested, including testing of communication from the PC's in Westboro, MA to the AS/400 in Philadelphia, PA.
- Copies of the BCP are not maintained at home locations by the various members of the recovery teams.

It is recommended that the Company perform adequate business impact analysis, which includes a review of the effects on each department from the most probable disaster causes. The plan should contain procedures detailing the activities of how and when the home location will be restored. There should also be a listing, by department, of the supplies needed in the event recovery needs to occur at an alternate facility. The Company should perform relevant, realistic testing of the plan, since a large part of plan maintenance is based on that testing. The plan should list the applications, operating systems, and data files that need to be recovered. Adequate and appropriate testing should include evidence that communications between the workgroup recovery location (Westboro) and the mainframe processing location (Philadelphia) may be relied upon. Lastly, copies of the BCP should be stored both on-site and off-site by each of the members of the three recovery teams (executive, technical, and business).

#### Agents' Balances or Uncollected Premiums

The examination asset for this captioned item is \$825,254 and is the same as the amount reported by the Company in its December 31, 2002 filed Annual Statement. Although the Company's amount has been accepted, the examination of this account identified several exceptions which are summarized as follows:

- Not all uncollected premium accounts are being reconciled to supporting documentation.
- Some reconciliations contain clearing accounts and other reconciling amounts which have not been researched and cleared in a timely manner.
- Netted in both the direct bill receivable and agency billing premium receivable balances were various clearing type accounts. The Company was unable to provide detail or identify the items comprising the clearing accounts.
- Included in the above balance is an agency premium and commission clearing account. This account is supposed to represent agency account installments that have not yet been billed. The Company was unable to provide a reconciliation for this account.
- Commissions due the Company's agents were netted in this asset account. Commissions due agents included a clearing account for which the amount included in the account could not be identified. In addition, the Company could not provide policy level detail to support the direct bill future commissions due.
- Certain reconciliations that were made available lacked the date the reconciliation was prepared and whom it was prepared by. Also, there was no evidence of supervisory review.

In light of the exceptions noted, it is recommended that the Company perform timely reconciliations and maintain policy level detail to support all accounts that comprise the Agents' balances or uncollected premiums account. Further, it is recommended that all clearing accounts be cleared on a timely basis. It is also recommended that reconciliations be dated and initialed by the preparer, and that the appropriate supervisor document evidence of a review.

The review of underlying documentation supporting Agents' balances or uncollected premiums over ninety days due also revealed exceptions. A summary of the exceptions noted follows:

- In accordance to SSAP No. 53 (Property Casualty Contracts–Premiums), 10% of the Earned but unbilled ("EBUB") premium in excess of any collateral specifically held and identifiable on a per policy basis shall be reported as a non-admitted asset. Currently, the Company nets commission expense with the EBUB premium prior to calculating the 10% non-admitted portion of the receivable. It was also noted that the Company does not properly reflect audit premium adjustments. The Company uses a blended rate for the EBUB audit premium adjustments. It does not appear that the Company's accounting systems properly identify all audit premium transactions, thereby not properly calculating the EBUB premiums.
- In accordance with SSAP No. 6 (Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers) "the uncollected agent's receivable on a policy by policy basis which is over ninety days due shall be non-admitted." SSAP No. 6 allows a company to offset the over ninety day non-admitted asset for credit balances (or an amount payable) due to an agent on a

policy by policy basis. However, the Company reduced its non-admitted asset on an agent by agent basis and not on a policy by policy basis.

It is recommended that the Company comply with SSAP No. 6 and SSAP No. 53 when calculating the 10% non-admitted portion of the over 90 day agent (premiums) receivable balance.

Finally, included in the Agents' balances or uncollected premiums account were several balances incorrectly classified as detailed below:

- The Company reported Agents' balances or uncollected premiums net of suspense cash accounts, and advance policy premium payments received. Proper statutory accounting requires that suspense cash accounts and advance policy premium payments received be recorded on the annual statement as a liability.
- The Company reported the installment portion of premiums receivable due from the Rhode Island Assigned Risk Pool under the caption, Premiums and agents' balances in course of collection. The balance should have been reported under the caption, Premiums, agents' balances and installments booked but deferred and not yet due.

It is recommended that the Company comply with the NAIC Annual Statement Instructions with regard to the reporting of balances relating to Agents' balances or uncollected premiums. Specifically, advance premiums and suspense accounts (those with credit balances) should be recorded as a liability.

#### Commissions Payable, Contingent Commissions and Other Similar Charges

The above liability, which is the same as that reported by the Company in its 2002 Annual Statement, represents profit sharing commissions due to the Company's agents as of December 31, 2002. Although no change has been made to the Company's reported amount, the Company could not provide one of the contracts requested, and also could not locate the commission rate schedule for an additional contract included in the sample tested.

It is recommended that the Company review its record keeping policy to ensure that all agents/agency contracts can be located upon request, and that the contracts include all the required written documentation.

#### Managing General Agents – Regulation 120

As discussed under the Territory and Plan of Operation caption of this report, the Company utilizes the services of one MGA to administer its business in specified territories. Department Regulation 120, Section 33.3(b)(1) requires all insurers utilizing the services of an MGA, to complete and file a form required by Section 33.3(c), to the Department within 30 days of the appointment. Upon requesting a copy of the form documenting the appointment of Treiber, it was determined that Treiber had not been formally appointed to represent the Company. The appointment had been made only for Treiber to represent the Company's affiliate, PWIC. Upon bringing this exception to management's attention, the appropriate documentation was filed to properly appoint Treiber as an MGA of the Company. The appointment became effective December 3, 2003.

### 3. FINANCIAL STATEMENTS

#### A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as determined by this examination as of December 31, 2002 and as reported by the Company:

| <u>Assets</u>   | <u>Assets</u>       | Nonadmitted<br><u>Assets</u> | Net Admitted<br><u>Assets</u> |
|---|---------------------|------------------------------|-------------------------------|
| Bonds   | \$25,926,487        |                              | \$25,926,487                  |
| Cash and short-term investments   | 906,926             |                              | 906,926                       |
| Premiums and agents' balances in course of collection                           | 876,304             | \$51,050                     | 825,254                       |
| Premiums, agents' balances and installments booked but deferred and not yet due | 2,794,739           | 10,392                       | 2,784,347                     |
| Federal and foreign income taxes recoverable and interest thereon               | 1,112,296           |                              | 1,112,296                     |
| Interest, dividends and real estate income due and accrued                      | 357,281             |                              | 357,281                       |
| Equities and deposits in pools and associations                                 | <u>579,688</u>      | <u>          </u>            | <u>579,688</u>                |
| Total assets  | <u>\$32,553,723</u> | <u>\$61,442</u>              | <u>\$32,492,281</u>           |

Liabilities, Surplus and Other Funds

| <u>Liabilities</u>   | <u>Examination</u>  | <u>Company</u>      | <u>Surplus<br/>Increase<br/>(Decrease)</u> |
|--|---------------------|---------------------|--|
| Losses and loss adjustment expenses                                    | \$24,091,928        | \$19,996,248        | \$(4,095,680)                              |
| Commission payable, contingent commission<br>and other similar charges | 165,380             | 165,380             |  |
| Other expenses   | 768,179             | 768,179             |  |
| Taxes, licenses and fees   | 289,281             | 289,281             |  |
| Unearned premiums  | 4,982,775           | 4,982,775           |  |
| Provision for reinsurance  | 755,604             | 0                   | (755,604)                                  |
| Payable to parent, subsidiaries and affiliates                         | 414,612             | 414,612             |  |
| Limited assignment distribution buyout payable                         | 56,000              | 56,000              |  |
| Loss portfolio transfer  | <u>(2,956,640)</u>  | <u>(2,956,640)</u>  | <u>                    </u>                |
| Total liabilities  | <u>\$28,567,119</u> | <u>\$23,715,835</u> | <u>\$(4,851,284)</u>                       |
| <br><u>Surplus and Other Funds</u>                                     |                     |                     |  |
| Loss portfolio transfer account  | \$2,476,640         | \$2,476,640         | \$   |
| Common capital stock   | 3,000,000           | 3,000,000           |  |
| Gross paid in and contributed surplus                                  | 2,500,000           | 2,500,000           |  |
| Unassigned funds (surplus)   | <u>(4,051,478)</u>  | <u>799,806</u>      | <u>(4,851,284)</u>                         |
| Surplus as regards policyholders                                       | <u>\$3,925,162</u>  | <u>\$8,776,446</u>  | <u>\$(4,851,284)</u>                       |
| Total liabilities and surplus  | <u>\$32,492,281</u> | <u>\$32,492,281</u> |  |

NOTE 1: As a result of this examination the Company's required to be maintained minimum surplus to policyholders is impaired in the amount of \$274,838.

NOTE 2: The Internal Revenue Service has not performed any audits of the Company's consolidated federal income tax returns through tax year 2002. The examiner is unaware of any potential exposure of the Company to any further tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders decreased \$6,497,366 during the four year examination period January 1, 1999 through December 31, 2002, detailed as follows:

Statement of Income

Underwriting Income

|                                      |              |                   |
|--------------------------------------|--------------|-------------------|
| Premiums earned                      |              | \$57,458,573      |
| Deductions:                          |              |                   |
| Loss incurred                        | \$40,929,853 |                   |
| Loss adjustment expenses incurred    | 9,694,568    |                   |
| Other underwriting expenses incurred | 18,295,798   |                   |
| Premium deficiency reserve           | <u>2,638</u> |                   |
| Total underwriting deductions        |              | <u>68,922,857</u> |
| Net underwriting gain (loss)         |              | \$(11,464,284)    |

Investment Income

|                              |                |           |
|------------------------------|----------------|-----------|
| Net investment income earned | \$6,375,904    |           |
| Net realized capital gains   | <u>723,085</u> |           |
| Net investment gain          |                | 7,098,989 |

Other income

|  |                  |                      |
|--|------------------|----------------------|
| Net gain or loss from agents' balances charged off                                       | \$(401,388)      |                      |
| Finance and service charges not included in premiums                                     | 417,758          |                      |
| Finance and service fees charged off   | (77,170)         |                      |
| Other income (expense)   | 3,745            |                      |
| Limited assignment distribution buyout costs   | (307,430)        |                      |
| Loss portfolio transfer gain   | <u>1,789,540</u> |                      |
| Total other income   |                  | <u>1,425,055</u>     |
| Net income before dividends to policyholders and before federal and foreign income taxes |                  | \$(2,940,240)        |
| Dividends to policyholders   |                  | <u>109,539</u>       |
| Net income before federal income taxes   |                  | \$(3,049,779)        |
| Federal income taxes incurred  |                  | <u>282,798</u>       |
| Net income   |                  | <u>\$(3,332,577)</u> |

C. Capital and Surplus Account

|   |                  |                    |                    |
|---|------------------|--------------------|--------------------|
| Surplus as regards policyholders, per report on examination as of December 31, 1998 |                  |                    | \$10,422,528       |
|   | <u>Gains</u>     | <u>Losses</u>      |                    |
| Net income  |                  | \$3,332,577        |                    |
| Net unrealized capital gains or losses  |                  | 31,451             |                    |
| Change in net deferred income tax   |                  | 60,488             |                    |
| Change in nonadmitted assets  | \$254,789        |                    |                    |
| Change in provision for reinsurance   |                  | 755,604            |                    |
| Cumulative effect of changes in accounting principles                               | 452,374          |                    |                    |
| Dividends to stockholders (cash)  |                  | 3,007,843          |                    |
| Reduction in reserve for workers' compensation discount                             | _____            | <u>16,566</u>      |                    |
| Total gains and losses  | <u>\$707,163</u> | <u>\$7,204,529</u> |                    |
| Net decrease in surplus as regards policyholders                                    |                  |                    | <u>(6,497,366)</u> |
| Surplus as regards policyholders, per report on examination as of December 31, 2002 |                  |                    | <u>\$3,925,162</u> |

**4. LOSSES AND LOSS ADJUSTMENT EXPENSES**

The examination liability for the captioned items of \$24,091,928 is \$4,095,680 greater than the \$19,996,248 reported by the Company in its 2002 Annual Statement. The difference between the examination liability and Company's reported liability represents 8% of the total reserve deficiency (8% of \$51,197,000).

The examination analysis of the losses 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.

During the actuarial review, it was determined that the Company did not disclose its assumed asbestos experience in the annual statement, notes to the financial statements (Note #29). It is recommended that the Company disclose its asbestos experience in its annual statement, notes to the financial statements in accordance with the NAIC Annual Statement Instructions.

## 5. PROVISION FOR REINSURANCE

The Company did not establish a Provision for reinsurance liability in its 2002 annual statement. The examination liability of \$755,604 (8% of \$9,445,050) represents the Company's share of the total Provision for reinsurance of the Providence Washington Insurance Companies calculated on a New York basis.

As discussed under the "Intercompany" reinsurance section of this report, the Company is a party to a pooling agreement with its affiliates. Under the provisions of Article V (Assignment and Allocation) of the pooling agreement, the lead company in the pool, Providence Washington Insurance Company, arranges all reinsurance on behalf of the pooled members, and retains all assets and liabilities associated with reinsurance with third parties. Further, the agreement stipulates that PWIC shall report and record all "third party reinsurance penalties." Accordingly, the Provision for reinsurance liability is recorded solely on the statutory balance sheet of PWIC.

During the current examination, the Department took exception to the manner in which the Company prepares the Schedule F of the annual statement. Because all pool members share in the write off of uncollectible reinsurance recoverables from unaffiliated reinsurers, the Department has taken the position that the Company must report its pooled share of all unaffiliated ceded reinsurance in its annual statement, Schedule F. Further, the Company must record a Provision for reinsurance based upon New York regulatory requirements. The position taken by the Department results in the difference between the Company and the examination liability.

In light of the aforementioned, it is recommended that the Company report its pooled share of amounts ceded to unaffiliated reinsurers in its annual statement, Schedule F. In addition, it is

recommended that the Company record as a liability, a Provision for reinsurance calculated in accordance with the provisions of the Department Regulations.

## **6. 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. Rating
- D. Claims and complaint handling

No problem areas were encountered.

## **7. SUBSEQUENT EVENTS**

In March of 2004, A.M. Best Company downgraded the financial strength of the Providence Washington Insurance Companies' from A- (Excellent) to B+ (Very Good), and placed the rating under review with negative implications. There is a possibility that additional capital could be infused into the Company during 2004. If the capital is received, A.M. Best would consider raising the financial strength rating. However, A.M. Best also stated that if the capital is not received, the rating would likely be further downgraded.

## 8. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

| <u>ITEM</u> |   | <u>PAGE NO.</u> |
|-------------|---|-----------------|
| A           | <u>Management</u>   |                 |
| i           | It is again recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.<br><br>The Company did not comply and a similar comment is contained in the current report on examination. | 6               |
| ii          | It is recommended that the board of directors hold four regular meetings per year pursuant to the Company's by-laws.<br><br>The Company has complied with this recommendation.  | 6               |
| B           | <u>Reinsurance</u>  |                 |
| i           | It is recommended that the Company report and account for adverse loss agreements in the manner prescribed by Regulation 108.<br><br>The Company has complied with this recommendation.   | 12              |
| ii          | It is recommended that the Company file a parental letter of credit application with this Department pursuant to Regulation 20.<br><br>The Company has complied with this recommendation.   | 12              |

| <u>ITEM</u> |   | <u>PAGE NO.</u> |
|-------------|---|-----------------|
| C           | <u>Custodial Agreement</u>  |                 |
| i           | It is recommended that the agreement between the insurer and the custodian should contain, at a minimum, the protective covenants and provisions deemed by this Department to be representative of good business practices for the contents of such agreements.                     | 16              |
|             | The Company has complied with this recommendation.  |                 |
| D           | <u>Abandoned Property Law</u>   |                 |
| i           | It is recommended that the Company maintain adequate records to report any abandoned property for the residents of this State.  | 17              |
|             | The Company has complied with this recommendation.  |                 |
| G           | <u>Internal Controls for Cash</u>   |                 |
| i           | It is recommended that at least two signatures be required to authorize payments over \$10,000 as required by the board's resolutions.  | 18              |
|             | This recommendation is no longer applicable to the Company.   |                 |
| ii          | It is recommended that only the individuals who are listed on bank resolutions be allowed to sign checks.   | 18              |
|             | This recommendation is no longer applicable to the Company.   |                 |
| iii         | It is recommended that the person authorized by the board resolution to designate banks as depositories should be the one who closes these accounts. Also, accounts that are closed should be supported by a board resolution as evidence that the board is aware of this activity. | 18              |
|             | This recommendation is no longer applicable to the Company.   |                 |
| iv          | It is recommended that to safeguard the assets of the Company, no one officer should be allowed to increase his or her signature limit.   | 18              |
|             | This recommendation is no longer applicable to the Company.   |                 |

## 9. SUMMARY OF COMMENTS AND RECOMMENDATIONS

| <u>ITEM</u>  | <u>PAGE NO.</u> |
|--|-----------------|
| A. <u>Capital Impairment</u>   |                 |
| As a result of this examination the Company's required to be maintained minimum surplus to policyholders is impaired in the amount of \$274,838.   | 1               |
| B. <u>Management</u>   |                 |
| It is again recommended that board members who are unable or unwilling to attend meetings consistently, resign or be replaced.   | 5               |
| C. <u>Reinsurance</u>  |                 |
| It is recommended that the Company comply with Article VIII of the pooling agreement by settling all intercompany balances within 45 days of the close of each calendar quarter.   | 10              |
| D. <u>Holding Company System</u>   |                 |
| It is recommended that the parties to the financial advisory agreement define the services to be provided by finalizing the written criteria, standards and guidelines to which the services are to be based, regardless if any management fees were incurred.   | 15              |
| E. <u>Abandoned Property Law</u>   |                 |
| It is recommended that the Company file its abandoned property reports on a timely basis pursuant to the provisions of Section 1316 of the New York Abandoned Property Law.  | 16              |
| F. <u>Accounts and Records</u>   |                 |
| i. <u>Internal Controls – EDP Systems</u>  |                 |
| It is recommended that the Company perform adequate business impact analysis, which includes a review of the effects on each department from the most probable disaster causes. The plan should contain procedures detailing the activities of how and when the home location will be restored. There should also be a listing, by department, of the supplies needed in the event recovery needs to occur at an alternate facility. The Company should perform relevant, realistic testing of the plan, since a | 18              |

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large part of plan maintenance is based on that testing. The plan should list the applications, operating systems, and data files that need to be recovered. Adequate and appropriate testing should include evidence that communications between the workgroup recovery location (Westboro) and the mainframe processing location (Philadelphia) may be relied upon. Lastly, copies of the BCP should be stored both on-site and off-site by each of the members of the three recovery teams (Executive, technical, and business).

G Agents' Balances or Uncollected Premiums

i. It is recommended that the Company perform timely reconciliations and maintain policy level detail to support all accounts that comprise the Agents' balances or uncollected premiums account. Further, it is recommended that all clearing accounts be cleared on a timely basis. It is also recommended that reconciliations be dated and initialed by the preparer, and that the appropriate supervisor document evidence of a review. 19

ii. It is recommended that the Company comply with SSAP No. 6 and SSAP No. 53 when calculating the 10% non-admitted portion of the over 90 day agent (premiums) receivable balance. 20

iii. It is recommended that the Company comply with the NAIC Annual Statement Instructions with regard to the reporting of balances relating to Agents' balances or uncollected premiums. Specifically, advance premiums and suspense accounts (those with credit balances) should be recorded as a liability. 20

H Commissions Payable, Contingent Commissions and Other Similar Charges

It is recommended that the Company review its record keeping policy to ensure that all agents/agency contracts can be located upon request, and that the contracts include all the required written documentation. 21

I. Losses and Loss Adjustment Expenses

It is recommended that the Company disclose its asbestos experience in its annual statement, notes to the financial statements in accordance with the NAIC Annual Statement Instructions. 25

J. Provision for Reinsurance

It is recommended that the Company report its pooled share of amounts ceded to unaffiliated reinsurers in its annual statement, Schedule F. In 27

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addition, it is recommended that the Company record as a liability, a Provision for reinsurance calculated in accordance with the provisions of the Department Regulations.



Appointment No. 22074

STATE OF NEW YORK  
INSURANCE DEPARTMENT

I, GREGORY V. SERIO, Superintendent of Insurance of the State of New York,  
pursuant to the provisions of the Insurance Law, do hereby appoint:

**John Tudino**

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

**PROVIDENCE WASHINGTON INSURANCE COMPANY OF NEW YORK**

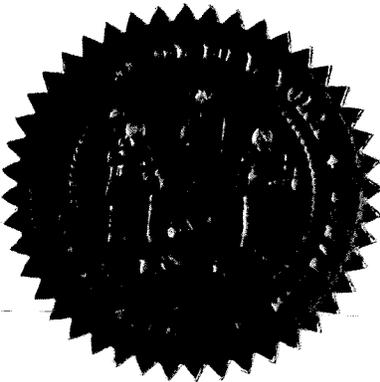
*and to make a report to me in writing of the condition of the said*

**COMPANY**

*with such other information as she 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 30th day of June, 2003*



  
\_\_\_\_\_  
GREGORY V. SERIO  
Superintendent of Insurance