

REPORT ON EXAMINATION

OF THE

LANCER INDEMNITY COMPANY
(formerly known as NORTH SEA INSURANCE COMPANY)

AS OF

DECEMBER 31, 2012

DATE OF REPORT

MARCH 7, 2014

EXAMINER

BERNARD LOTT

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NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Benjamin M. Lawsky
Superintendent

March 7, 2014

Honorable Benjamin M. Lawsky
Superintendent of Financial Services
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 31064 dated September 27, 2013, attached hereto, I have made an examination into the condition and affairs of Lancer Indemnity Company (formerly known as North Sea Insurance Company) as of December 31, 2012, and submit the following report thereon.

Wherever the designation “the Company” appears herein without qualification, it should be understood to indicate the Lancer Indemnity Company.

Wherever the term “Department” appears herein without qualification, it should be understood to mean the New York State Department of Financial Services.

The examination was conducted at the Company’s home office located at 370 West Park Avenue, Long Beach, New York 11561.

1. SCOPE OF EXAMINATION

The Department has participated in a coordinated group examination of the Company, a multi-state insurer. The previous examination was conducted as of December 31, 2008. This examination covered the four-year period from January 1, 2009 through December 31, 2012. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination was conducted in conjunction with the state of Illinois, which acted as the coordinating state. It was performed concurrently with the examination of Lancer Insurance Company (“LIC”), an affiliated insurer domiciled in Illinois.

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

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

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

- Significant subsequent events
- Company history
- Corporate records
- Management and control
- Fidelity bonds and other insurance
- Territory and plan of operation
- Growth of Company
- Loss experience

Reinsurance
Accounts and records
Statutory deposits
Financial statements
Summary of recommendations

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

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

2. DESCRIPTION OF COMPANY

The Company was incorporated on October 26, 1978 under the laws of the State of New York, as the North Sea Insurance Company. It was licensed and commenced business on December 31, 1979.

On January 1, 2009, Lancer Financial Group, Inc. purchased North Sea Holdings Inc., the Company's parent. In 2012 North Sea Holdings Inc. dividended the Company and its remaining assets to Lancer Financial Group and then dissolved. Effective January 1, 2013, the Company changed its name to Lancer Indemnity Company

Capital paid in is \$4,000,000, consisting of 500,000 shares of common stock with a par value of \$8 per share. Gross paid in and contributed surplus is \$2,800,000. In 2010, the Company increased the par value of its common stock from \$3.20 to \$3.40 per share, which increased paid in capital by \$100,000 and decreased gross paid in and contributed surplus by the same amount. In 2011, the Company received a surplus contribution from its ultimate parent, Lancer Financial Group, Inc., in the amount of \$3,300,000. The \$3,300,000 was used to increase the Company's paid in capital by \$2,300,000 by increasing the par value from \$3.40 to \$8.00 per share. The remaining \$1,000,000 was added to gross paid in and contributed surplus. The following chart shows the changes to paid in capital and gross paid in and contributed surplus during the examination period:

<u>Date</u>	<u>Description</u>	<u>Paid in Capital</u>	<u>Gross Paid in and contributed surplus</u>
1/1/2009	Beginning balance (500,000 shares at \$3.20/share)	\$1,600,000	\$1,900,000
2010	Increased par value from \$3.20 to \$3.40/share	100,000	(100,000)
2011	Capital contribution and increase in par value from \$3.40 to \$8.00 per share	<u>2,300,000</u>	<u>1,000,000</u>
12/31/2012	Ending balance (500,000 shares at \$8.00/share)	<u>\$4,000,000</u>	<u>\$2,800,000</u>

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than seven nor more than thirteen members. However, for the years ending 2011 and 2012, the Company had only six members serving on its board of directors. The board met thirteen times during the period covered by this examination. At December 31, 2012, the board of directors was comprised of the following six members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Robert F. Boyle Massapequa, NY	Executive Vice President and Chief Operating Officer, Lancer Indemnity Company
Leonard S. Caronia Park Ridge, IL	Co-Chairman - Financial Institutions Group, Macquarie Capital
George N. Cochran Kenilworth, IL	Co-Chairman - Financial Institutions Group, Macquarie Capital
David P. Delaney, Jr. Ponte Vedra Beach, FL	President, Lancer Insurance Company
Timothy D. Delaney Islamorada, FL	Senior Executive Vice President, Lancer Insurance Company
John N. Lombardo Naples, FL	Retired

It is recommended that the Company comply with Section 1201(a)(5)(B)(v) of the New York Insurance Law and Article III, Section 3.01 of its own by-laws and maintain at least seven members on its board of directors. Subsequent to the examination date, the Company's board of directors appointed an additional board member.

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

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

<u>Name</u>	<u>Title</u>
David P. Delaney, Jr.	President
John A. Petrilli	Secretary
Alistair T. Lind	Chief Financial Officer and Treasurer
Robert F. Boyle	Executive Vice President and Chief Operating Officer
Wayne S. Ricci	Executive Vice President

B. Territory and Plan of Operation

As of December 31, 2012, the Company was licensed to write business in nineteen states, however, during the period covered by this examination, it has only written in three states: New Jersey, New York and Pennsylvania. 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
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
16	Fidelity and surety
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity

The Company is empowered to transact such workers' compensation insurance as may be incident to coverages 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 Cong. as amended; 33 USC Section 901 et seq. as amended). In addition, the Company is licensed to write Special Risk Insurance pursuant to Article 63 of the New York Insurance Law.

Based on the lines of business for which the Company is licensed and its current capital structure, and pursuant to the requirements of Articles 13, 41 and 63 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders of \$1,950,000.

The Company specializes in providing commercial multiple peril, general liability, fire and allied lines coverage to small and medium-size businesses. The operations are geographically concentrated in the New York City and Long Island, NY, regions.

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

<u>Calendar Year</u>	<u>New York State</u>	<u>Total Premiums</u>	<u>Premiums Written in New York State as a Percentage of Total Premium</u>
2009	\$4,102,298	\$4,582,302	89.52%
2010	\$3,932,124	\$4,437,643	88.61%
2011	\$4,942,088	\$5,698,426	86.41%
2012	\$5,363,860	\$6,321,685	84.85%

C. Reinsurance

The Company does not assume any reinsurance business. The Company has structured its ceded reinsurance program to limit its maximum risk as follows:

<u>Type of Treaty</u>	<u>Cession</u>
<u>Multiple Line – Excess of Loss Property</u>	\$750,000 excess of \$250,000 each risk in any one occurrence; limit \$2,250,000 for all risks in any one loss occurrence.
<u>Casualty</u>	\$750,000 excess of \$250,000 ultimate net loss, any one loss occurrence.
<u>Casualty Excess of Loss</u>	\$1,000,000 excess of \$1,000,000 per each occurrence.
<u>Casualty Clash</u>	\$2,000,000 excess of \$2,000,000 per each occurrence.

<u>Type of Treaty</u>	<u>Cession</u>
<u>Property Per Risk Excess of Loss</u>	\$1,250,000 excess of \$1,000,000 each risk, any one loss occurrence.
<u>Property Catastrophe Excess of Loss</u>	\$5,000,000 excess of \$1,000,000 per occurrence.

All ceded business was with an authorized reinsurer and all 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.

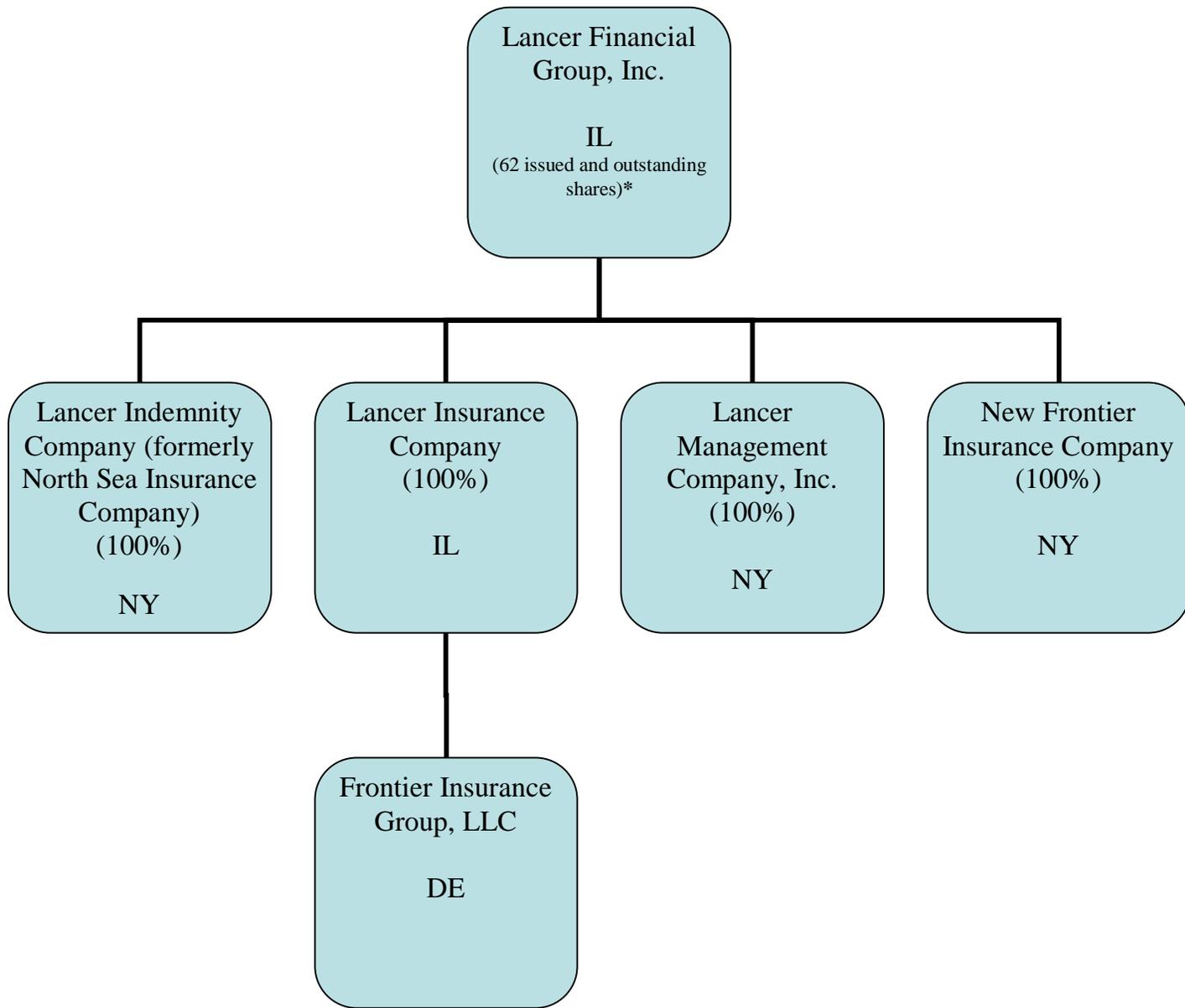
The examination review found that the Schedule F data reported by the Company in its filed annual statement accurately reflected its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62R. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's Chief Executive Officer and Chief Financial Officer pursuant to the NAIC Annual Statement Instructions. The review found that the Company was not a party to any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in SSAP No. 62R.

D. Holding Company System

The Company is a member of the Lancer Financial Group and is a wholly-owned subsidiary of Lancer Financial Group Inc., an Illinois corporation.

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 an abridged chart of the holding company system at December 31, 2012:



* - Ownership of Lancer Financial Group, Inc. is as follows:

Common Shares
David P. Delaney, Jr. 11 shares (17.74%)
Timothy D. Delaney, 11 shares (17.74%)
Oxford Group, LLC, 6shares (9.68%)
David P. Delaney, Jr. 2010 GRAT, 9 shares (14.52%)
Timothy D. Delaney, 2010 GRAT, 9 shares (14.52%)
David P. Delaney, Jr. 2011 GST Trust, 8 shares (12.90%)
Timothy D. Delaney, 2011 GST Trust, 8 shares (12.90%)

At December 31, 2012, the Company was party to the following agreements with other members of its holding company system:

Tax Allocation Agreement

Effective January 1, 2009, the Company entered into a tax allocation agreement with the members of its holding company system. Under this agreement, federal income tax is computed as if the Company were filing a separate federal income tax return, except that income tax benefits are recognized to the extent utilized in a consolidated federal income tax return. The tax allocation agreement provides for the establishment of an escrow account by the parent for the benefit of the Company in order to maintain the Company's rights to recoup federal income taxes paid to the parent in the event of future net losses.

Inter-Company Expense Agreement

Effective January 1, 2009, the Company entered into an intercompany expense agreement with affiliates Lancer Insurance Company, an Illinois domestic insurance company and Lancer Management Company, Inc., a New York corporation. The agreement provides for the purchasing of services and use of a facility related to the operation of the respective businesses. This includes, but is not limited to office space, data processing, personnel, legal, auditing and other services.

Underwriting Management Agreement

Effective July 1, 2012, the Company entered into an underwriting management agreement with an affiliate, Lancer Management Company, Inc. ("LMC"), a New York corporation. The agreement grants LMC the authority to act as underwriting manager for the Company in the marketing, solicitation, binding and issuance of policies of insurance.

All agreements were filed with the Department as required by Section 1505 of the New York Insurance Law.

E. Significant Operating Ratios

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

Net premiums written to surplus as regards policyholders	.35 to 1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	42%
Premiums in course of collection to surplus as regards policyholders	7%

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 four-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$3,827,010	55.10%
Other underwriting expenses incurred	4,898,283	70.52
Net underwriting loss	<u>(1,779,390)</u>	<u>(25.62)</u>
Premiums earned	<u>\$6,945,903</u>	<u>100.00%</u>

3. FINANCIAL STATEMENTS

A. Balance Sheet

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

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$13,494,229	\$ 0	\$13,494,229
Cash, cash equivalents and short-term investments	1,223,384		1,223,384
Receivables for securities	5,100		5,100
Investment income due and accrued	91,595		91,595
Uncollected premiums and agents' balances in the course of collection	713,269		713,269
Deferred premiums, agents' balances and installments booked but deferred and not yet due	302,847		302,847
Amounts recoverable from reinsurers	157,933		157,933
Current federal and foreign income tax recoverable and interest thereon	115,880		115,880
Net deferred tax asset	298,628	30,514	268,114
Receivables from parent, subsidiaries and affiliates	18,772		18,772
Aggregate write-ins for other than invested assets	<u>24,834</u>	<u>24,834</u>	<u>0</u>
Total assets	<u>\$16,446,471</u>	<u>\$55,348</u>	<u>\$16,391,123</u>

Liabilities, surplus and other fundsLiabilities

Losses and loss adjustment expenses	\$ 3,168,055
Other expenses (excluding taxes, licenses and fees)	56,010
Taxes, licenses and fees (excluding federal and foreign income taxes)	25,693
Unearned premiums	2,937,699
Ceded reinsurance premiums payable (net of ceding commissions)	<u>382,756</u>
Total liabilities	\$ <u>6,570,213</u>

Surplus and Other Funds

Common capital stock	\$4,000,000
Gross paid in and contributed surplus	2,800,000
Unassigned funds (surplus)	<u>3,020,910</u>
Surplus as regards policyholders	<u>9,820,910</u>
Total liabilities, surplus and other funds	\$ <u>16,391,123</u>

Note: The Internal Revenue Service has commenced a limited scope audit of the consolidated Federal Income Tax returns for tax years 2010 and 2011. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Statement of Income

Surplus as regards policyholders increased \$3,639,041 during the four-year examination period January 1, 2009 through December 31, 2012, detailed as follows:

Underwriting Income

Premiums earned		\$6,945,903
Deductions:		
Losses and loss adjustment expenses incurred	\$3,827,010	
Other underwriting expenses incurred	<u>4,898,283</u>	
Total underwriting deductions		<u>8,725,293</u>
Net underwriting loss		\$(1,779,390)

Investment Income

Net investment income earned	\$1,402,474	
Net realized capital gain	<u>436,035</u>	
Net investment gain or (loss)		1,838,509

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (5,519)	
Finance and service charges not included in premiums	8,000	
Aggregate write-ins for miscellaneous income	<u>32,765</u>	
Total other income		<u>35,246</u>
Net income before federal and foreign income taxes		\$ <u>94,365</u>
Federal and foreign income taxes incurred		<u>(158,532)</u>
Net Income		\$ <u>252,897</u>

Surplus as regards policyholders per report on examination as of December 31, 2008				\$6,181,869
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>		
Net income	\$252,897			
Net unrealized capital gains or (losses)	108,377			
Change in net deferred income tax		83,573		
Change in nonadmitted assets	61,340			
Capital changes paid in	2,400,000			
Surplus adjustments paid in	<u>900,000</u>			
Net increase in surplus	<u>\$3,722,614</u>	<u>\$83,573</u>		<u>\$3,639,041</u>
Surplus as regards policyholders per report on examination as of December 31, 2012				<u>\$9,820,910</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$3,168,055 is the same as reported by the Company as of December 31, 2012. The examination analysis of the Loss and loss adjustment expense reserves was conducted in accordance with generally accepted actuarial principles and statutory accounting principles, including the NAIC Accounting Practices & Procedures Manual, Statement of Statutory Accounting Principle No. 55 (“SSAP No. 55”). The data underlying our analysis was derived from statistical information contained in the Company’s internal records and its filed annual statements.

5. **COMPLIANCE WITH PRIOR REPORT ON EXAMINATION**

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

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Accounts and Records</u> It is recommended that the Company exercise greater care in preparing Schedule P for future annual statement filings.	10

The Company has complied with this recommendation.

6. **SUMMARY OF COMMENTS AND RECOMMENDATIONS**

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u> It is recommended that the company comply with Section 1201(a)(5)(B)(v) of the New York Insurance Law and Article III, Section 3.01 of its own by-laws and maintain at least seven members on its board of directors.	4

Subsequent to the examination date, the Company's board of directors appointed an additional board member.

Respectfully submitted,

_____/s/
Bernard Lott

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

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

_____/s/
Bernard Lott

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:

Bernard Lott

as a proper person to examine the affairs of the

Lancer Indemnity Company

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

COMPANY

with such other information as he shall deem requisite.

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

this 27th day of September, 2013

BENJAMIN M. LAWSKY
Superintendent of Financial Services



By:

Jean Marie Cho
Deputy Superintendent