

REPORT ON EXAMINATION

OF THE

EASTERN MUTUAL INSURANCE COMPANY

AS OF

DECEMBER 31, 2009

DATE OF REPORT

FEBRUARY 8, 2011

EXAMINER

NYANTAKYI AKUOKO

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

February 8, 2011

Honorable James J. Wrynn
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 30577 dated August 13, 2010 attached hereto, I have made an examination into the condition and affairs of Eastern Mutual Insurance Company as of December 31, 2009, and submit the following report thereon.

Wherever the designations "the Company" or "EMIC" appear herein without qualification, they should be understood to indicate Eastern Mutual Insurance Company.

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

The examination was conducted at the Company's home office located at 6504 State Route 32, Greenville, New York 12083.

1. SCOPE OF EXAMINATION

The Department has performed a single-state examination of Eastern Mutual Insurance Company. The previous examination was conducted as of December 31, 2004. This examination covered the five-year period from January 1, 2005 through December 31, 2009. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

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

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process. 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 Financial Condition Examiners Handbook of the NAIC:

- 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
- 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 departure from laws, regulations or rules, or that are deemed to require explanation or description.

2. DESCRIPTION OF COMPANY

Eastern Mutual Insurance Company was organized on January 8, 1855, as the Farmers' Fire Insurance Association of the Towns of Greenville, Durham, Westerlo, and Rensselaerville for the purpose of transacting business as an assessment co-operative fire insurance corporation in the counties of Greene and Albany in this State. Subsequently, the Company's territory was extended to include all of the counties of New York State, excluding the counties of New York, Kings, Queens, Bronx and Richmond.

In 1969, this Department approved a change in the name of the Company to the Eastern Co-operative Insurance Company. Effective July 1, 1992, this Department approved a merger of Schoharie & Schenectady Mutual Insurance Association into Eastern Co-operative Insurance Association (surviving corporation). Concurrent with the merger, the Company's license was amended to indicate its new name, Eastern Mutual Insurance Company.

Effective November 21, 2001, this Department approved a change in the Company's charter to amend its license to include boiler and machinery.

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 nine nor more than fifteen members. The board meets four times during each calendar year. At December 31, 2009, the board of directors was comprised of the following nine members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Valerie A. Davis Greenville, NY	Vice President & Secretary, Eastern Mutual Insurance Company
Robert E. Flagler Berne, NY	Chairman of the Board, EMIC & Chestertown Brokers, Inc.

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Elizabeth J. Friedland Albany, NY	Retired
Scott T. Jeffers Oriskany Falls, NY	President, Sauquoit Valley Insurance Company
Kent L. Johnson Rensselaer, NY	Associate Director, IT Infrastructure, Rensselaer Polytechnic Institute Director, Chestertown Brokers, Inc.
William R. Scrafford Greenville, NY	President & Treasurer, EMIC President, Chestertown Brokers, Inc.
Allyn P. Wright Medusa, NY	Self-employed, Forestry Consultant Director, Chestertown Brokers, Inc.
Fred S. Zeitler Greenville, NY	Self-employed, Certified Public Accountant
Alan P. Zuk Berne, NY	Retired Transport Coordinator, Berne Knox-Westerlo School District Director, Chestertown Brokers, 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.

As of December 31, 2009, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
John H. Fitzhugh	Chief Executive Officer
Michael W. Nobles	Chief Financial Officer
William R. Scrafford	President & Treasurer
Valerie A. Davis	Vice President & Secretary
Susan M. Fancher	Vice President-Underwriting

B. Territory and Plan of Operation

As of December 31, 2009, the Company was licensed to write business in New York only.

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

<u>Paragraph</u>	<u>Line of Business</u>
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability (excluding workers' compensation)
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine

The Company is also licensed to accept and cede reinsurance as provided in Section 6606 of the New York Insurance Law.

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

<u>Calendar Year</u>	<u>Direct Premiums Written (000's)</u>
2005	\$6,996
2006	\$7,120
2007	\$7,239
2008	\$7,183
2009	\$7,099

Based on the lines of business for which the Company is licensed and pursuant to the requirements of Articles 13 and 66 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$100,000. The Company writes predominantly commercial multiple peril and homeowners multiple peril lines of business, which accounted for 56% and 27%, respectively, of the 2009 direct premium writings. The Company writes mainly through independent agents and one agent who is also a director of the Company.

C. Reinsurance

During the period covered by this examination, the Company reported no assumed reinsurance business.

The Company has structured its ceded reinsurance program as follows:

<u>Type of Treaty</u>	<u>Cession</u>
Property Excess of Loss	\$500,000 excess of \$100,000 each loss, each risk, subject to a further limit of \$1,000,000 any one loss occurrence.
Property per Risk	\$2,400,000 excess of \$600,000 ultimate net loss, each risk subject to a limit of \$4,800,000 as respects all property losses resulting from one occurrence.
Boiler and Machinery	100% cession not exceeding \$25,000,000 any one accident.
Specified Catastrophe Perils	\$575,000 excess of \$25,000 each loss, each risk subject to a further limit of \$1,150,000 each loss occurrence.
Casualty (2 layers)	\$900,000 excess of \$100,000, ultimate net loss per occurrence.
Casualty Clash	\$2,000,000 excess of \$1,000,000 in any one loss occurrence, with respect to those kinds of insurance classified as casualty business.
Casualty Excess of Loss	\$1,000,000 excess of \$1,000,000, each loss occurrence.
Aggregate Excess of Loss	95% of \$750,000 aggregate net loss, any one contract year, in excess of 72.5% of the net premium earned, in any one calendar year.

As of December 31, 2009, the Company maintained catastrophe excess of loss coverage on a per occurrence basis:

<u>Type of Treaty</u>	<u>Cession</u>
Property (3 layers)	95% of \$670,000 excess of \$130,000 ultimate net loss, any one occurrence, involving three or more risks.
	100% ultimate net loss in excess of \$800,000.

All reinsurance contracts in effect throughout the examination period were reinsured by authorized reinsurers.

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

Reinsurance agreements with its affiliate were reviewed for compliance with Article 15 of the New York Insurance Law. It was noted that all affiliated reinsurance agreements were filed with the Department pursuant to the provisions of Section 1505(d)(2) of the New York Insurance Law.

The examination review of the Schedule F data contained in the Company's filed annual statements indicated that its reinsurance transactions were accurately reported. Management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in the NAIC Accounting Practices and Procedures Manual, Statements of Statutory Accounting Principles ("SSAP") No. 62. Representations were supported by an attestation from the Company's officers. Additionally, the examination review indicated that the Company was not a party to any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in paragraphs 26 and 27 of SSAP No. 62.

D. Holding Company System

i. Affiliation with Union Mutual Fire Insurance Company

As of December 31, 2009, the Company was affiliated with Union Mutual Fire Insurance Company ("Union Mutual"), a Vermont based insurance company, by virtue of an affiliation agreement, common management, service agreements and reinsurance agreements.

On May 26, 2000, the Department approved an affiliation agreement between the Company and Union Mutual. The approval paved the way for Union Mutual to provide specified services to the Company. As of December 31, 2009, Union Mutual provided data processing, underwriting support, investment, and accounting management services to the Company under agreements filed with the Department.

Also, during the examination period, the Company ceded reinsurance to Union Mutual, its affiliate, under the following reinsurance agreements: property and casualty excess of loss, property per risk excess of loss, third casualty excess of loss, aggregate excess of loss and equipment breakdown.

ii. Chestertown Brokers, Inc.

In February 1982, this Department approved the organization of a wholly-owned subsidiary called Chestertown Brokers, Inc. (“Chestertown”). The purpose of the brokerage subsidiary was to provide additional property and casualty outlets to agents of the Company or those lines of business not written by the Company. In 1987, the directors of the Company appointed Chestertown as an agent of the Company.

The Company has contributed capital to the subsidiary by purchasing thirty shares of \$100 par value common stock at \$200 per share for a total investment of \$6,000. It is noted that at December 31, 2009, the Company valued its subsidiary at \$63,470 which represents the entity’s audited net worth at such date.

Chestertown is sited at the Company’s home office. An agreement was entered into between the Company and the subsidiary whereby the Company provides specified management and operational services to Chestertown. The agreement also provides for operating expenses incurred and paid for by the Company to be allocated between the two companies in a manner consistent with SSAP No. 70.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2009, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	57%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	49%
Premiums in course of collection to surplus as regards policyholders	2%

All of the above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

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

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$12,158,490	48.75%
Other underwriting expenses incurred	9,903,160	39.71
Net underwriting gain	<u>2,878,095</u>	<u>11.54</u>
Premiums earned	<u>\$24,939,745</u>	<u>100.00%</u>

F. Accounts and Records

i. Misclassification of Asset

Paragraph 2 of SSAP No. 26 defines bonds to include certificates of deposits (“CDs”) and commercial paper that have a fixed schedule of payments and a maturity date in excess of one year from the date of acquisition. The examination review revealed that the Company reported a CD with maturity term in excess of one year from the date of acquisition as cash on Schedule E Part 1. Therefore, it is recommended that the Company comply with SSAP No. 26 and classify as bonds any certificate of deposit that has a fixed schedule of payments and a maturity date in excess of one year from the date of acquisition.

ii. Custodial Agreement

The NAIC Financial Condition Examiners Handbook (“Handbook”) provides recommended safeguards and controls that should be included in a custodial or safekeeping agreement. Upon examination, it was found that the agreement between the Company and its custodian did not contain some of the recommended provisions set forth in the Handbook. Accordingly, it is recommended that the Company amend its custodial agreement to include the recommended safeguards and controls as set forth in the NAIC Financial Condition Examiners Handbook.

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2009 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	\$11,857,383	\$ 0	\$11,857,383
Common stocks	1,206,958	0	1,206,958
Properties occupied by the company	618,356	0	618,356
Cash, cash equivalents and short-term investments	1,574,773	0	1,574,773
Investment income due and accrued	157,144	0	157,144
Uncollected premiums and agents' balances in the course of collection	149,952	277	149,675
Deferred premiums, agents' balances and installments booked but deferred and not yet due	1,099,646	2,035	1,097,611
Amounts recoverable from reinsurers	212,630	0	212,630
Current federal and foreign income tax recoverable and interest thereon	35,000	0	35,000
Net deferred tax asset	434,960	29,486	405,474
Electronic data processing equipment and software	1,116	1,116	0
Furniture and equipment, including health care delivery assets	9,385	9,385	0
Receivables from parent, subsidiaries and affiliates	<u>281</u>	<u>0</u>	<u>281</u>
Total assets	<u>\$17,357,584</u>	<u>\$42,299</u>	<u>\$17,315,284</u>

Liabilities, Surplus and Other FundsLiabilities

Losses and loss adjustment expenses		\$ 4,204,303
Commissions payable, contingent commissions and other similar charges		192,971
Other expenses (excluding taxes, licenses and fees)		26,374
Taxes, licenses and fees (excluding federal and foreign income taxes)		5,769
Unearned premiums		3,625,039
Advance premium		78,004
Ceded reinsurance premiums payable (net of ceding commissions)		127,364
Amounts withheld or retained by company for account of others		53,803
Remittances and items not allocated		4,980
Payable to parent, subsidiaries and affiliates		<u>20,262</u>
Total liabilities		\$ 8,338,869

Surplus and Other Funds

Aggregate write-ins for other than special surplus funds	\$ 64,600	
Unassigned funds (surplus)	<u>8,911,818</u>	
Surplus as regards policyholders		<u>8,976,418</u>
Total liabilities, surplus and other funds		<u>\$17,315,284</u>

NOTE: The Internal Revenue Service has begun to audit the Company's tax return covering tax year 2008. It appears that there is a potential exposure of the Company to additional tax assessments; however, as the audit has not been completed no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$3,845,611 during the five-year examination period January 1, 2005 through December 31, 2009, detailed as follows:

Underwriting Income

Premiums earned		\$24,939,745
Deductions:		
Losses and loss adjustment expenses incurred	\$12,158,490	
Other underwriting expenses incurred	<u>9,903,160</u>	
Total underwriting deductions		<u>22,061,650</u>
Net underwriting gain or (loss)		\$ 2,878,095

Investment Income

Net investment income earned	\$ 2,035,578	
Net realized capital gain	<u>(91,720)</u>	
Net investment gain or (loss)		\$ 1,943,858

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (54,077)	
Finance and service charges not included in premiums	573,020	
Aggregate write-ins for miscellaneous income	<u>(1,130)</u>	
Total other income		\$ <u>517,813</u>
Net income before federal and foreign income taxes		\$ 5,339,766
Federal and foreign income taxes incurred		<u>1,678,392</u>
Net income		\$ <u>3,661,374</u>

Surplus as regards policyholders per report on examination as of December 31, 2004			\$5,130,807
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$3,666,830		
Net transfers (to) from protected cell accounts			
Net unrealized capital gains or (losses)	139,094	\$ 0	
Change in net deferred income tax		77,114	
Change in nonadmitted assets	52,201		
Aggregate write-ins for gains and losses in surplus	<u>64,600</u>	<u>0</u>	
Total gains and losses	<u>\$3,922,725</u>	<u>\$77,114</u>	
Net increase (decrease) in surplus			<u>3,845,611</u>
Surplus as regards policyholders per report on examination as of December 31, 2009			<u>\$8,976,418</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$4,204,303 is the same as reported by the Company as of December 31, 2009. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Company's internal records and in its filed annual statements.

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
A. It was recommended that the Company comply with Section 308 of the NYIL and Circular Letter 17 of 2001 by filing transactions involving the Company and affiliates as prescribed by Article 15 of the New York Insurance Law.	8
The Company has complied with this recommendation.	
B. It was recommended that the Company prepare Schedule P Part 3E Column 12 in accordance with the NAIC annual statement instructions.	10
The Company has complied with this recommendation.	

<u>ITEM</u>	<u>PAGE NO.</u>
C.	
i.	15
<p>It was recommended that the Company comply with Part 216(e) of the Department Regulation 64 and Circular Letter 11 of 1978 and maintain a complaint log that registers and monitors all complaint activities in a format put forth by Circular Letter 11 of 1978.</p> <p>The Company has complied with this recommendation.</p>	
ii.	16
<p>It was recommended that the Company comply with all of the requirements set forth in Part 218.4(b) of this Department's Regulation 90 when sending notices of termination of agents' contracts or accounts.</p> <p>The Company has complied with this recommendation.</p>	

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A.	
<p><u>Accounts and Records</u></p>	
i.	9
<p>It is recommended that the Company comply with SSAP No. 26 and classify as bonds any certificate of deposit that has a fixed schedule of payments and a maturity date in excess of one year from the date of acquisition.</p>	
ii.	9
<p>It is recommended that the Company amend its custodial agreement to include the recommended safeguards and controls as set forth in the NAIC Financial Condition Examiners Handbook.</p>	

Respectfully submitted,

_____/S/_____
Nyantakyi Akuoko
Senior Insurance Examiner

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

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

_____/S/_____
Nyantakyi Akuoko

Subscribed and sworn to before me

this _____ day of _____, 2011.

STATE OF NEW YORK
INSURANCE DEPARTMENT

I, James J. Wrynn Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:

Nyantakyi Akuoko

as proper person to examine into the affairs of the

EASTERN MUTUAL INSURANCE COMPANY

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 13th day of August, 2010



James J. Wrynn

JAMES J. WRYNN
Superintendent of Insurance