

REPORT ON EXAMINATION
OF THE
NORTH COUNTRY INSURANCE COMPANY
AS OF
DECEMBER 31, 2002

DATE OF REPORT:

OCTOBER 12, 2004

EXAMINER:

WARREN YOUNGS

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STATE OF NEW YORK
INSURANCE DEPARTMENT
ONE COMMERCE PLAZA
ALBANY, NEW YORK 12257

George E. Pataki
Governor

Gregory V. Serio
Superintendent

October 12, 2004

Honorable Gregory V. Serio
Superintendent of Insurance
Albany, New York 12257

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 22069, dated June 23, 2003, attached hereto, I have made an examination into the condition and affairs of the North Country Insurance Company as of December 31, 2002 and submit the following report thereon.

The examination was conducted at the Company's home office located at 21170 NYS Route 232, Watertown, New York 13601.

Wherever the designations "the Company" or "NCIC" appear herein without qualification, they should be understood to indicate the North Country Insurance Company.

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 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 certified 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 bonds and other insurance
- Territory and plan of operation
- Growth of Company
- Business in force by states
- Loss experience
- Reinsurance
- Accounts and records
- Financial statements
- Market conduct activities

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 organized on May 27, 1877 as the Jefferson County Patron's Fire Relief Association, for the purpose of transacting business as an assessment cooperative fire insurance association in the Counties of Jefferson and Lewis, in New York State.

On March 6, 1958, this Department issued a certificate changing the Association's corporate title to the North Country Co-operative Insurance Company.

The North Country Co-operative Insurance Company merged with the Oneida County Grange Co-operative Fire Insurance Company on February 2, 1961, the Adirondack Cooperative Insurance Company on January 1, 1984, the Farmers' Fire and Lightning Insurance Company of Oneida County on January 1, 1985, and the Westmoreland Co-operative Insurance Association on January 1, 1987.

Upon the merger of the Adirondack Cooperative Insurance Company into the North Country Co-operative Insurance Company on January 1, 1984, a new corporate name, the North Country Adirondack Cooperative Insurance Company, became effective.

As of October 1, 1991, the Company merged with the St. Lawrence County Farmers Insurance Company. A new corporate name, North Country Insurance Company, became effective at that time.

Effective September 1, 1996, the Company converted from an assessment co-operative company to an advance premium company.

North Country Insurance Company merged with Chenango Mutual Insurance Company, A Cooperative and Heritage Mutual Insurance Company effective January 1, 1997 and January 1, 1998 respectively. North Country Insurance Company was the surviving corporation.

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 twenty-one members. As of the examination date, the board of directors was comprised of thirteen members.

At least four board meetings were held in each of the years during the period under examination, thereby complying with Section 6624(b) of the New York Insurance Law.

The directors as of December 31, 2002 were as follows:

| <u>Director</u> | <u>Principal Business Affiliation</u> |
|--|--|
| Edgar Amyot Hammond, NY | Dairy Farmer; Director of Rices Road Corporation |
| Neil Raymond Bartle Oxford, NY | Vice President of NCIC; President and Chief Executive Officer of Blue Ox Oil; Director of Rices Road Corporation |
| Stephen James Duflo Adams, NY | President of NCIC; Director and President of Rices Road Corporation |
| Paul Truman Evans Potsdam, NY | Dairy Farmer; Insurance Agent for NCIC; Director of Rices Road Corporation |
| Marc Edgar Ladouceur Watertown, NY | Chief Operating Officer of NCIC; Director and Vice President of Rices Road Corporation |
| Charles Thomas Langdon Wellesley Island, NY | Part-time consultant/major account salesman for Mohawk Valley Cash Register; Director of Rices Road Corporation |
| William Maloy Gouverneur, NY | Retired; Maloy Trailer Sales (part time) |
| Camil George Maroun, Jr. Tupper Lake, NY | Independent Insurance Agent; Director of Rices Road Corporation |
| Michelle Danine Pfaff Dexter, NY | Vice President and Commercial Loan Manager of Community Bank; Director of Rices Road Corporation |

| <u>Director</u> | <u>Principal Business Affiliation</u> |
|---------------------------------------|--|
| John Edward Scott Watertown, NY | Independent Insurance Agent; Director of Rices Road Corporation |
| Robert Lewis Stine Redwood, NY | Dairyman; Insurance Agent for NCIC; Director of Rices Road Corporation |
| John James Wheeler Watertown, NY | Controller for Climax Manufacturing Company; Director of Rices Road Corporation |
| George Edward Woodruff Redwood, NY | Treasurer of NCIC; Director and Treasurer of Rices Road Corporation |

The minutes of all of the Board of Directors' meetings and the committees thereof held during the examination period were reviewed. Such review indicated that all of the meetings were well attended. Each of the directors had a satisfactory attendance record for the board meetings held.

Each of the director's qualifications, as set forth in Article IV of the Company's charter and Article III Section 1 of its by-laws, were reviewed and it appears that each director was duly qualified.

During the review of the Company's charter, by-laws and its corporate minutes it was found that the Company violated several sections of its charter and by-laws during the period under examination. Thus, it is recommended that the Company adhere to all the provisions of its charter and by-laws, henceforth. It is noted that a similar recommendation was included in the previous report on examination.

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

| | |
|-------------------------|------------------------|
| President | Stephen James Duflo |
| Chief Operating Officer | Marc Edgar Ladouceur |
| Secretary | Cora Arlinda Donahue |
| Treasurer | George Edward Woodruff |
| Vice President | Neil Raymond Bartle |

B. Territory and Plan of Operation

The Company is licensed to transact business within the entire State of New York. The Company writes in New York State only.

| <u>Calendar Year</u> | <u>Direct Premiums Written (000's)</u> |
|----------------------|--|
| 1999 | \$18,588 |
| 2000 | 18,323 |
| 2001 | 17,757 |
| 2002 | 17,515 |

As of December 31, 2002, 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>Kind of Insurance</u> |
|------------------|---|
| 4 | Fire |
| 5 | Miscellaneous property |
| 6 | Water Damage |
| 7 | Burglary and theft |
| 8 | Glass |
| 12 | Collision |
| 13 | Personal injury liability |
| 14 | Property damage liability |
| 19 | Motor vehicle and aircraft physical damage |
| 20 | Marine and inland marine (inland marine only) |

The Company was also licensed as of December 31, 2002, to accept and cede reinsurance as provided in Section 6606 of the Insurance Law of the State of New York.

Based upon the lines of business for which the Company is licensed, and pursuant to the requirements of Articles 13, 41 and 66 of the New York Insurance Law, as of December 31, 2002, the Company is required to maintain a minimum surplus to policyholders in the amount of \$445,801.

At December 31, 2002, the Company wrote insurance through independent agents and several director agents. The Company's predominate lines of business are farmowners multiple peril, homeowners multiple peril and commercial multiple peril, which accounted for 20.27%, 46.92% and 23.76%, respectively, of the Company's 2002 direct written business.

C. Reinsurance

The Company reported no assumed business during the examination period.

The Schedule F's as contained in the Company's Annual Statements filed for the years within the examination period were found to be completed improperly in that the Company did not report all of the reinsurers in accordance with the annual statement instructions. In addition, the Company did not correctly complete the notes to financial statements section of its filed annual statements with regard to its unsecured reinsurance recoverables. It is noted that similar findings were found during the previous examination.

The examiner reviewed all ceded reinsurance contracts effected during the examination period. These contracts all contained the required standard clauses including insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

As of December 31, 2002 the Company had the following property and casualty excess of loss reinsurance program in place:

| | |
|-------------------|--|
| Property 2 layers | \$609,375 in excess of \$140,625 any one loss, any one risk. Each layer has a limit for all risks involved in one occurrence as follows: First--\$418,750 and Second--\$800,000. |
| Casualty 3 layers | \$925,000 in excess of \$75,000 any one occurrence. |
| Casualty Clash | \$2,000,000 in excess of \$1,000,000 in any one loss occurrence. |

The property program has a net line quota share component of 50% of the net retained liability for a maximum recovery of \$70,312.50 (50% of \$140,625) per risk, per loss, subject to

an occurrence limit of \$180,000. This effectively reduces the Company's property net retention from \$140,625 to \$70,312.50 per risk, per loss.

As of December 31, 2002, the Company also maintained catastrophe excess of loss coverage on a per occurrence basis:

| | |
|-------------------|---|
| Property 3 layers | 95% of \$14,500,000 in excess of \$500,000, subject to a limit on each separate layer during the term of the agreement as follows: First--\$2,850,000; Second--\$5,700,000 and Third--\$19,000,000. |
|-------------------|---|

The Company also had the following aggregate excess of loss reinsurance coverage in place as of December 31, 2002:

| | |
|-----------------------|---|
| Property and Casualty | 100% of \$1,200,000 of net losses occurring during the term of the contract, in excess of 75% of net premiums earned. |
|-----------------------|---|

At December 31, 2002 the Company had property pro rata facultative reinsurance coverage providing for a maximum cession of the lesser of 50% of the entire risk or \$500,000. Risks where the total insured value exceeds \$1,000,000 may be underwritten on an offer and acceptance basis.

The Company ceded to predominately authorized reinsurers during the period under examination. There were no recoveries as of December 31, 2002 due from unauthorized reinsurers.

Since the date of the prior examination, December 31, 1998, the Company's net retention after quota share reinsurance increased from \$51,000 to \$70,312.50 on property business. The Company increased its property quota share percentage from 15% to 50% since the prior exam and on its casualty business, the Company's net retention increased from \$50,000 to \$75,000.

D. Holding Company System

The Company had one wholly owned subsidiary as of December 31, 2002, Rices Road Corporation. The subsidiary owns the Company's home office building in Watertown, N.Y. and another adjacent building that it leases to a third party.

Section 1608(b) of the New York Insurance Law states, in part, that "All transactions between the insurer and its subsidiaries shall be fair and equitable, charges or fees for services performed shall be reasonable..."

Section 1608(c) of the New York Insurance Law states that "The books, accounts and records of each party to all such transactions shall be so maintained as to clearly and accurately disclose the nature and details of the transactions, including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties."

During the course of this examination the Company did not provide adequate documentation to support the reasonableness of the charges or fees to the respective parties as required by Section 1608(c). Thus, the Company's compliance with Section 1608(b) of the New York Insurance Law could not be determined.

In view of the above, it is recommended that the Company maintain and provide upon examination the records required by Section 1608(c) of the New York Insurance Law in order for the Company's compliance with Section 1608(b) of the New York Insurance Law to be determined. It is noted that a similar recommendation was included in the previous report on examination.

E. 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 | 2.68 to 1 |
| Liabilities to liquid assets (cash and invested assets less investments in affiliates) | 90.97% |
| Premiums in course of collection to Surplus as regards policyholders | 33.38% |
| Surplus aid to policyholders surplus | 26.62% |
| Two-year overall operating ratio | 107.75% |
| Investment yield | 3.00% |
| Change in policyholders surplus | -21.53% |

The above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners, except for the Surplus aid to policyholders surplus ratio, the Two-year overall operating ratio, the Investment yield ratio and the Change in policyholders surplus ratio.

The Surplus aid to policyholders surplus ratio, the Two-year overall operating ratio and the Investment yield ratio were beyond the benchmark ranges before any examination changes. The Change in policyholders surplus ratio went beyond the benchmark range because of the examination decrease to the Company's December 31, 2002 surplus.

It is noted that this is the third examination in a row where the Company has had IRIS ratio results that are outside the benchmark ranges.

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 expenses incurred | \$35,132,325 | 74.11% |
| Other underwriting expenses incurred | 17,653,834 | 37.24% |

| | | |
|------------------------------|---------------------|-----------------|
| Net underwriting gain (loss) | <u>(5,378,706)</u> | <u>(11.35)%</u> |
| Premiums earned | <u>\$47,407,453</u> | <u>100.00%</u> |

F. Abandoned Property

During the period covered by this examination, the Company filed reports with the state comptroller that generally complied with the requirements of the New York Abandoned Property Law.

It is noted that the Company has written procedures related to the handling of unclaimed funds.

G. Loans to Officers and Directors – Section 1411(f)(1) of the New York Insurance Law

The Company sold two of its cars to an individual who is an officer and director of NCIC around April 1, 2000. Such person did not pay for the cars up front, but rather on an installment basis (loan). The officer and director subsequently sold one of the cars to someone else and paid the Company for that car. However, the other loan was not paid off until December 9, 2002.

The above transaction would be considered a loan to an officer/director in violation of Section 1411(f)(1) of the New York Insurance Law.

In correspondence dated October 6, 2003 the Company indicated that it would follow the provisions of Section 1411(f)(1) of the New York Insurance Law in the future.

Nevertheless, it is recommended that the Company comply with the requirements of Section 1411(f)(1) of the New York Insurance Law and not make loans to officers or directors.

H. Accounts and Records

i. General System Controls

A review of internal controls, relative to the Company's data processing function revealed that the Company does not have a standard operations procedures manual nor a

documentation standards manual. System documentation controls require the presence of adequate standards for documentation and compliance with them.

In view of the above, it is recommended that the Company develop a standard operations procedures manual and a documentation standards manual in order to strengthen its electronic data processing function controls. It is noted that a similar recommendation was included in the previous report on examination.

ii. Approval of Investments

Section 1411(a) of the New York Insurance Law states, in part, that “No domestic insurer shall make any loan or investment ... unless authorized or approved by its board of directors or a committee thereof responsible for supervising or making such investment or loan. The committee’s minutes shall be recorded and a report submitted to the board of directors at its next meeting.”

During the review of the Company’s investments to determine if they were properly approved, it was determined that the Company was not having its board approve all of its investments. Thus, the Company was not complying with the requirements of Section 1411(a).

In correspondence dated January 22, 2004 the Company acknowledged that its board of directors did not approve all of its investments and that it would be taking corrective action regarding this matter.

Nevertheless, it is recommended that the Company comply with the requirements of Section 1411(a) of the New York Insurance Law by having all of its investments authorized or approved as indicated in such section. It is noted that a similar recommendation was included in the previous report on examination.

iii. CPA Contracts

The Company's CPA contracts for 2001 and 2002 did not meet all the requirements of Department Regulation 118. After bringing such requirements to the attention of Company management, the 2002 agreement was brought into compliance. In correspondence dated September 30, 2003, the Company indicated that future agreements with its CPA firm would comply with Regulation 118.

Nevertheless, it is recommended that the Company ensure that its contracts with its CPA firm covering all future audit years meet the requirements of Department Regulation 118.

iv. Allocation of Expenses

This Department's Regulation No. 30 (11NYCRR105-109) sets forth the rules and methods governing the allocation of expenses among the major expense groups (loss adjustment, other underwriting and investment). This regulation also requires insurers to maintain detailed worksheets on file, supporting percentages used in allocating expenses to the various expense groups.

Management could not provide detailed worksheets to support the allocation of each expense category to a particular expense group. Thus, there was no viable way to determine whether the Company correctly allocated expenses, as per the rules found in the regulation.

Management is directed to establish and maintain written documentation supporting the allocation of each expense category to the major expense groups as required by this Department's Regulation No. 30. It is noted that a similar recommendation was included in the previous report on examination.

During the review of the Company's expense allocations to the various expense categories it was found that the Company was not allocating some expenses in accordance with this Department's Regulation 30.

In correspondence dated October 1, 2003 the Company management acknowledged that it did not classify some of its expenses in accordance with Regulation 30. In addition, it indicated that it would take corrective action regarding this matter.

Nevertheless, it is recommended that the Company allocate its expenses to each expense category in accordance with Department Regulation 30.

v. Signature Requirements on Company Checks

During the course of the examination it was found that the Company was allowing agents and company adjusters (non-officers) to sign NCIC loss checks.

Section 6611(a)(4)(C) of the New York Insurance Law states that "All checks issued shall be signed by two officers or by one officer upon the written order of another officer, except as otherwise provided by resolution of the corporation's board of directors or in its by-laws for handling of miscellaneous expenses."

Losses cannot be considered miscellaneous expenses for the purposes of Section 6611(a)(4)(C) of the New York Insurance Law.

Thus, it is recommended that, henceforth, the Company comply with Section 6611(a)(4)(C) of the New York Insurance Law with regard to having the required number of officers' signatures on all Company checks. It is noted that a similar recommendation was included in the previous report on examination.

vi. Equities and Deposits in Pools and Associations

The Company recorded the net amount of its portion of premiums, losses, expenses and other operations of pools and associations as “Miscellaneous Income” in its 2002 filed annual statement contrary to the requirements of SSAP No. 63 paragraph 8.

SSAP No. 63 paragraph 8 states, in part, that “Underwriting results shall be accounted for on a gross basis whereby the participant's portion of premiums, losses, expenses, and other operations of the pools are recorded separately in the financial statements rather than netted against each other ...”

In a written statement dated March 30, 2004, the Company acknowledged that it did not fully comply with SSAP No. 63. It stated further that in the future, the Company would comply with the requirements of SSAP No. 63.

Nevertheless, it is recommended that the Company comply fully with SSAP No. 63 paragraph 8 and record premiums, losses, expenses and other operations of pools and associations separately in the financial statements and not net them against each other. A similar recommendation was made in the prior examination report regarding the separate recording of the Company's portion of premiums, losses, expenses and other operations of pools and associations.

vii. Custodianship of Securities

As of December 31, 2002 the Company owned 1,387 common shares of Northern New York Bancorp, Inc. of which 647 shares were held by a broker.

Department Circular Letter No. 2 (1977) indicates that a custodian bank should hold an insurance company's securities under an acceptable custodial agreement.

During September and November 2003 the Company did sell the 647 common shares of Northern New York Bancorp, Inc. that were held by the broker. Since the Company sold the securities prior to the end of this examination it was allowed admitted asset credit for the securities held by the broker as of December 31, 2002.

In view of the above, it is recommended that the Company comply with Department Circular Letter No. 2 (1977) and only allow its investments to be held under custodial arrangements that meet the requirements put forth in the circular letter. It is noted that a similar recommendation was included in the previous report on examination.

viii. Compliance with the Annual Statement Instructions

During the review of the Company's filed annual statements numerous instances were found of the Company not following the annual statement instructions. See the following sections of the report for additional information:

- a. Section 2(C) "Reinsurance"
- b. Section 4 "CASH"
- c. Section 6 "RECEIVABLE FOR SECURITIES"
- d. Section 7 "AGENTS' BALANCES OR UNCOLLECTED PREMIUMS"
- e. Section 11 "ADVANCE PREMIUMS"
- f. Section 12 "REMITTANCES AND ITEMS NOT ALLOCATED"

In addition to the above, the following instances were found of the 2002 annual statement not being completed in accordance with its instructions:

- During the review of the Company's filed 2002 Schedule D it was found that some of the presented information was inaccurate for certain securities. Thus, the Company was not complying with the annual statement instructions because it was not filling out Schedule D

accurately. The Company acknowledged in correspondence dated November 19, 2003 that it did not record the securities correctly and indicated that in the future it would take additional precautions when preparing statements to ensure that all details for securities are accurately stated.

- The Company did not complete the Underwriting and Investment Exhibit line 12 “Net gain (loss) from agents’ or premium balances charged off”. Amounts that were supposed to be reflected on this line were mixed in with other amounts reported else where on the exhibit. In correspondence dated March 29, 2004 the Company acknowledged that is was not following the annual statement instructions for line 12 and that it was in the process of developing a procedure to ensure that it is completed correctly in the future.

Thus, it is recommended that the Company complete all financial statements filed with this Department in accordance with such statement’s instructions, henceforth. It is noted that a similar recommendation was included in the previous report on examination.

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. The figures included in these financial statements have been rounded.

| <u>Assets</u> | <u>Examination</u> | | <u>Company</u> | | <u>Surplus Increase (Decrease)</u> |
|---|----------------------|----------------------------|----------------------------|----------------------------|------------------------------------|
| | <u>Ledger Assets</u> | <u>Non Admitted Assets</u> | <u>Net Admitted Assets</u> | <u>Net Admitted Assets</u> | |
| Bonds | \$8,129,588 | \$ | \$8,129,588 | \$8,129,588 | \$ |
| Preferred stocks | 307,160 | | 307,160 | 307,160 | |
| Common stocks | 2,989,636 | | 2,989,636 | 2,989,636 | |
| Cash | 255,790 | 612,554 | (356,764) | 255,790 | (612,554) |
| Short-term investments | 1,513,936 | 34,174 | 1,479,762 | 901,382 | 578,380 |
| Receivable for securities | 34,174 | | 34,174 | 0 | 34,174 |
| Agents' balances or uncollected premiums | 3,543,609 | 33,334 | 3,510,275 | 3,534,540 | (24,265) |
| Reinsurance recoverables on loss and loss adjustment expense payments | 228,911 | | 228,911 | 228,911 | |
| Electronic data processing equipment and software | 29,581 | | 29,581 | 29,581 | |
| Interest, dividends and real estate income due and accrued | 162,826 | | 162,826 | 162,826 | |
| Equities and deposits in pools and associations | 346,303 | | 346,303 | 346,303 | |
| Other assets non-admitted | 75,725 | 75,725 | | | |
| Aggregate write-ins for other than invested assets | <u>1,410</u> | | <u>1,410</u> | <u>1,410</u> | |
| Total assets | <u>\$17,618,649</u> | <u>\$755,787</u> | <u>\$16,862,862</u> | <u>\$16,887,127</u> | <u>\$(24,265)</u> |

| <u>Liabilities & Surplus</u> | <u>Examination</u> | <u>Company</u> | <u>Surplus Increase (Decrease)</u> |
|--|---------------------|---------------------|--|
| Losses and Loss adjustment expenses | \$6,687,754 | \$6,439,754 | \$(248,000) |
| Commissions payable, contingent commissions and other similar charges | 419,185 | 419,185 | |
| Other expenses (excluding taxes, licenses and fees) | 101,945 | 80,653 | (21,292) |
| Unearned premiums | 5,560,669 | 4,930,650 | (630,019) |
| Advance premiums | 9,000 | | (9,000) |
| Ceded reinsurance premiums payable (net of ceding commissions) | 576,730 | 576,730 | |
| Amounts withheld or retained by company for account of others | 93,820 | 93,820 | |
| Remittances and items not allocated | 26,063 | | (26,063) |
| Provision for reinsurance | 4,200 | 4,200 | |
| Aggregate write-ins for liabilities | | 26,063 | 26,063 |
| | | | |
| Total liabilities | <u>\$13,479,366</u> | <u>\$12,571,055</u> | <u>\$(908,311)</u> |
| Required surplus | \$ 445,801 | \$ 479,787 | (33,986) |
| Surplus notes | 2,000,000 | 2,000,000 | |
| Unassigned funds (surplus) | <u>937,695</u> | <u>1,836,285</u> | <u>(898,590)</u> |
| Surplus as regards policyholders | <u>\$3,383,496</u> | <u>\$4,316,072</u> | <u>\$(932,576)</u> |
| Total liabilities and surplus as regards policyholders | <u>\$16,862,862</u> | <u>\$16,887,127</u> | |

The Company issued a \$2,000,000 surplus note dated October 20, 2000 to Holyoke Mutual Insurance Company in Salem, a mutual insurance company incorporated pursuant to the laws of Massachusetts. The note has a maturity date of November 1, 2010. The interest rate is 9%. The New York Insurance Department on October 6, 2000 approved the terms of the surplus note.

In conjunction with the surplus note the two parties entered into a loan agreement and memorandum of understanding also dated October 20, 2000. The memorandum of understanding was not objected to by the New York Insurance Department.

The surplus note is subject to the provisions of Section 1307 of the New York Insurance Law and as such the payment of principal and interest under the note requires the prior approval of the Superintendent of the New York Insurance Department. The amount of the surplus note shall not be part of the legal liabilities of the Company.

The Internal Revenue Service did not audit the Company's federal income tax returns for the years under examination. Audits covering subsequent tax years have yet commence. Except for any impact that might result from the examination changes contained in this report, 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 by \$28,577 during the four-year examination period, January 1, 1999 to December 31, 2002, detailed as follows:

Statement of Income

Underwriting Income

| | | |
|--------------------------------------|-------------------|-------------------|
| Premiums earned | | \$47,407,453 |
| Losses and loss expenses incurred | \$35,132,325 | |
| Other underwriting expenses incurred | <u>17,653,834</u> | |
| Total underwriting deductions | | <u>52,786,159</u> |
| Net underwriting gain (loss) | | \$(5,378,706) |

Investment Income

| | | |
|--|------------------|-----------|
| Net investment income earned | \$2,046,169 | |
| Net realized capital gains or (losses) | <u>1,677,422</u> | |
| Net investment gain or (loss) | | 3,723,591 |

Other Income

| | | |
|--|----------------|------------------|
| Finance and service charges not included in premiums | \$1,367,788 | |
| Aggregate write-ins for miscellaneous income | <u>492,171</u> | |
| Total other income | | <u>1,859,959</u> |
| Net income before federal income taxes | | \$204,844 |
| Federal income taxes incurred | | <u>0</u> |
| Net income (loss) | | <u>\$204,844</u> |

Capital and Surplus Account

| | | | |
|---|-----------------------------|------------------------------|--------------------|
| Surplus as regards policyholders, December 31, 1998, per prior report on examination | | | \$3,412,073 |
| | <u>Gains in Surplus</u> | <u>Losses in Surplus</u> | |
| Net income or loss | \$204,844 | \$ 0 | |
| Net unrealized capital gain or (losses) | 0 | 1,861,176 | |
| Change in non-admitted assets | 596,395 | 0 | |
| Change in provision for reinsurance | 0 | 4,200 | |
| Change in surplus notes | 2,000,000 | 0 | |
| Cumulative effect of changes in accounting principles | 0 | 178,178 | |
| Aggregate write-ins | <u>0</u> | <u>786,262</u> | |
| Total gains and losses | <u>\$2,801,239</u> | <u>\$2,829,816</u> | |
| Net decrease in surplus as regards policyholders | | | <u>(28,577)</u> |
| Surplus as regards policyholders, December 31, 2002 per report on examination | | | <u>\$3,383,496</u> |

4. CASH

The examination admitted asset of \$(356,764) is \$612,554 less than the \$255,790 reported by the Company as of December 31, 2002. The examination decrease is explained below.

Statement of Statutory Accounting Principles ("SSAP") No. 2 section 3 states that "Also classified as cash for financial statement purposes, although not falling within the above definition of cash, are savings accounts and certificates of deposit in banks or other similar financial institutions with maturity dates within one year or less from the acquisition date, and cash equivalents. Cash equivalents are short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present

insignificant risk of changes in value because of changes in interest rates. Only investments with original maturities of three months or less qualify under this definition."

Additional guidance is provided on the classification of fund investments in Issue Paper No. 28 section 11 and in the annual statement instructions.

During the review of what the Company reported as cash in its 2002 annual statement it was found that such amount included balances in a fund that should not have been reported as cash or cash equivalents based upon the guidance cited above, but rather as short-term investments. In correspondence dated December 5, 2003 the Company did agree to take corrective action regarding this matter. Nevertheless, it is recommended that the Company classify cash, cash equivalents and short-term investments in accordance with Statement of Statutory Accounting Principles No. 2, Issue paper No. 28 and the annual statement instructions.

5. SHORT-TERM INVESTMENTS

The examination admitted asset of \$1,479,762 is \$578,380 more than the \$901,382 reported by the Company in its 2002 filed annual statement. The difference can be broken down as follows:

| <u>Description</u> | <u>Amount</u> |
|---|------------------|
| Transfer to Receivable for Securities | \$(34,174) |
| Reclassification of fund balances from Cash to Short-term investments | <u>612,554</u> |
| Total | <u>\$578,380</u> |

See sections 4 and 6 of this report for additional information.

6. RECEIVABLE FOR SECURITIES

The Company reported no admitted asset under this caption as of December 31, 2002. This examination has established the captioned admitted asset in the amount of \$34,174, which

was transferred from the admitted asset Short-term Investments. See section 5 of this report for additional information.

The Company sold an investment on December 30, 2002; however, it didn't receive the proceeds of the sale until January 3, 2003. The Company added the amount of the proceeds \$34,174 to its short-term investments as of December 31, 2002, even though it didn't receive the funds until January 3, 2003.

Per SSAP No. 21 Paragraph 6: "Sales of securities are recorded as of the trade date. A receivable due from the broker is established in instances when a security has been sold, but the proceeds from the sale have not yet been received."

In correspondence dated October 1, 2003, Company management indicated that the Company did account for this transaction improperly and that the Company would follow the annual statement instructions for Receivables for Securities in the future.

Nevertheless, it is recommended that the Company follow the requirements of SSAP 21 and the annual statement instructions relative to recording proceeds from the sale of investments that have not been received.

7. AGENTS' BALANCES OR UNCOLLECTED PREMIUMS

The examination admitted asset of \$3,510,275 is \$24,265 less than the \$3,534,540 reported by the Company in its 2002 filed annual statement. The examination decrease can be broken down as follows:

1. \$9,000 was transferred to the liability account Advance Premiums. The Company had used such amount as an offset to this captioned admitted asset. See section 11 of this report for additional information.

2. The Company included in this asset \$33,265 of premiums that would be considered not admitted based upon Section 1301(a)(11) and (12) of the New York Insurance Law and SSAP No. 6 paragraph 9. Thus, for examination purposes the over 90 days past due premium receivable amounts were not admitted.

In correspondence dated March 24, 2004, the Company indicated that it had taken corrective action regarding the proper reporting of uncollected premiums. Nevertheless, it is recommended that the Company comply with Sections 1301(a)(11) and (12) of the New York Insurance Law and with SSAP No. 6 paragraph 9 by not admitting agents' balances or uncollected premiums that are over 90 days past due.

The Company is not correctly reporting the amounts on Lines 10.1 ("Premiums and agents' balances in course of collection") and 10.2 ("Premiums, agents' balances and installments booked but deferred and not yet due") of the "Assets" page in the annual statement. Line 10.1 of page 2 of the 2002 annual statement should include premiums or installment premiums due on or before the statement date. Line 10.2 should include premiums or installment premiums due after the statement date. The Company is currently reporting on line 10.2 receivables on policies that have had at least one installment payment, regardless of the due dates of the remaining installments.

It is noted that the prior report on examination also noted that the Company was not performing the allocation between lines 10.1 and 10.2 properly. In a correspondence dated March 24, 2004, the Company acknowledged that it allocated agents' balances or uncollected premiums to the wrong lines of the annual statement asset page and that it would take corrective action regarding this matter. See section 2(H)(viii) of this report for additional information.

8. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability of \$6,687,754 is \$248,000 more than the \$6,439,754 reported by the Company in its 2002 filed annual statement.

The Department's 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. Such analysis indicated that the Company's loss and loss adjustment expense reserves were not adequate as of December 31, 2002 by the examination increase noted above.

Section 1303 of the New York Insurance Law states, in part, that "Every insurer shall ... maintain reserves in an amount estimated in the aggregate to provide for the payment of all losses or claims incurred on or prior to the date of statement, whether reported or unreported, which are unpaid as of such date and for which such insurer may be liable, and also reserves in an amount estimated to provide for the expenses of adjustment or settlement of such losses or claims."

In view of the above, it is recommended that the Company increase its carried loss and loss adjustment reserves by the amount of the deficiency noted in this write-up and reflect such increase in future financial statements filed with this Department. In addition, it is recommended that the Company provide an adequate reserve for unpaid losses and loss adjustment expenses in all future financial statements filed with this Department in order to comply with the requirements of Section 1303 of the New York Insurance Law. A similar recommendation was included in the prior report on examination.

9. OTHER EXPENSES (EXCLUDING TAXES, LICENSES AND FEES)

The examination liability of \$101,945 is \$21,292 more than the \$80,653 reported by the Company in its 2002 filed annual statement. The examination increase resulted from the following:

1. An examination increase of \$9,336 to this liability based upon an analysis of disbursements made subsequent to December 31, 2002 that were applicable to the period under examination.
2. The Company used \$11,956 of prepaid expenses (2003 expenses paid in 2002) to reduce this liability. This is in violation of Section 1302(a)(2) of the New York Insurance Law, which requires prepaid expenses to be shown as a not admitted asset.

In correspondence dated September 22, 2003, the Company agreed to comply with Section 1302(a)(2) of the New York Insurance Law in the future. Nevertheless, it is recommended that the Company not take admitted asset credit for pre-paid expenses as required by Section 1302(a)(2) of the New York Insurance Law.

10. UNEARNED PREMIUMS

The examination liability for unearned premiums of \$5,560,669 is \$630,019 more than the \$4,930,650 reported by the Company in its 2002 filed annual statement. The examination increase is explained below.

During the review of the Company's calculation of its unearned premium reserve as of December 31, 2002 it was found that the Company was using the monthly pro rata method; however, the Company was not allocating its written premium to the actual month the policy became effective. Based on information provided to the examiners, the Company's recorded written premium for each month of 2002, except December, included approximately three weeks

of premiums related to the month following. For example, premium recorded as January written premiums was made up of three weeks of written premium with February effective dates.

According to the Company it made adjustments at the end of the year to subtract out January 2003 written premiums from the 2002 written premiums. When the Company recorded the written premium in a month prior to the actual effective date of the policy and then applied the monthly pro rata calculation method to such premium amounts the Company ended up applying a lower monthly unearned factor than was appropriate. Such misallocation of premiums to the wrong effective month is the major cause of the examination difference noted above.

Section 1305(a) of New York Insurance Law states, in part, that “Every authorized insurer shall...maintain reserves equal to the unearned portions of the gross premiums charged on unexpired or unexpired risks and policies.” The Company’s methods of recording written premiums and the application of lower unearned premium factors to the misallocated written premiums, resulted in the understatement of the unearned premium liability, as of December 31, 2002.

The Statement of Statutory Accounting Principles, (“SSAP”) No.53 paragraph 5, states that, “Written premiums for all other contracts shall be recorded on the effective date of the contract. Upon recording written premium, a liability, the unearned premium reserve, shall be established to reflect the amount of premium for the portion of the insurance coverage that has not yet expired.” The Company’s method of recording written premiums as detailed above did not comply with SSAP No. 53 paragraph 5.

In correspondence dated March 1, 2004, Company management indicated that it had determined that the method used by the Company to record its written premiums was not correct and that it had changed the method from the transaction date to the effective date method in the

year 2003. In addition, the Company indicated that based upon the changes made that it believes it is currently in compliance with Section 1305(a) of the New York Insurance Law and SSAP No. 53.

Nevertheless, it is recommended that the Company comply with Section 1305(a) of the New York Insurance Law by maintaining reserves equal to the unearned portions of the gross premiums charged on unexpired or unexpired risks and policies. It is also recommended that the Company comply with SSAP No. 53 by recording written premiums on the effective date of the contracts.

11. ADVANCE PREMIUMS

The Company reported no liability under this caption as of December 31, 2002. This examination has established the caption liability in the amount of \$9,000. Such amount was transferred from the asset Agents' Balances or Uncollected Premiums for report purposes. See section 7 of this report for additional information.

During the review of the amount reported as Agents' balances or uncollected premiums in the Company's 2002 annual statement it was found that the Company was including premiums received prior to the effective date of the contract as an offset to such asset.

Statement of Statutory Accounting Principles ("SSAP") No. 53 paragraph 13 indicates that advance premiums result when the policies have been processed, and the premium has been paid prior to the effective date. These advance premiums are reported as a liability in the statutory financial statement and not considered income until due.

The 2002 annual statement instructions require premiums received prior to the effective date of the contract to be included on Page 3 line 10 "Advance premiums" of such statement.

In correspondence dated November 21, 2003 the Company agreed to take corrective action regarding this matter. Nevertheless, it is recommended that the Company comply with SSAP No. 53 paragraph 13 and the annual statement instructions and show premiums received prior to the effective date of the contract as a liability and not as an offset to agents' balances or uncollected premiums.

12. REMITTANCES AND ITEMS NOT ALLOCATED

The Company reported no liability under this caption as of December 31, 2002. This examination has established the caption liability in the amount of \$26,063.

The Company reported this amount in the annual statement as "Advance Payments," under the "Aggregate write-ins for liabilities" caption. Such amount represents premium payments received with the application for policies, which have not yet been issued and premium payments in an amount different than the amount billed by the company. The amount was transferred from the write-in liability for report purposes. See section 13 of this report for additional information.

SSAP No. 67 paragraph 9 indicates that cash receipts cannot always be identified for a specific purpose or, for other reasons, applied to a specific account when received. The reporting entity shall record a liability for these cash receipts when the funds are received. These liability accounts are generally referred to as suspense accounts. Examples include:

- a. Premium payments received with the application for policies, which have not yet been issued;
- b. Premium payments in an amount different than the amount billed by the reporting entity; and
- c. Unidentified cash receipts.

The 2002 annual statement instructions require cash receipts that cannot be identified for a specific purpose or, for other reasons, cannot be applied to a specific account when received to be included on Page 3 line 15 "Remittances and items not allocated" of such statement.

In correspondence dated November 2003 the Company agreed to take corrective action regarding this matter. Nevertheless, it is recommended that the Company comply with SSAP No. 67 paragraph 9 and the annual statement instructions and show cash receipts that cannot be identified for a specific purpose or, for other reasons, applied to a specific account when received under the liability caption Remittances and items not allocated instead of as a write-in liability.

13. AGGREGATE WRITE-INS FOR LIABILITIES

The Company reported a liability in the amount of \$26,063 as of December 31, 2002. Pursuant to this examination, the liability has been eliminated. The \$26,063 was transferred to the liability "Remittances and items not allocated". See section 12 of this report for additional information.

14. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business practices and fulfills its contractual obligations to policyholders and claimants.

The review was general in nature and is not to be construed to encompass the generally more precise scope of a market conduct investigation.

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

- 1) Sales and advertising
- 2) Underwriting
- 3) Rating

4) Treatment of policyholders and claimants

Except as noted below, no unfair practices were encountered.

Department Regulation 90

The Company's procedures for canceling agents' agreements were reviewed whereupon it was determined that the Company was not following all the requirements of this Department's Regulation No. 90.

Part 218.4(b) of Regulation No. 90 requires that all notices to agents or brokers that their contract or account is to be terminated shall be mailed or delivered to the affected agent or broker at least 30 days prior to the effective date of such termination.

Part 218.5 of Regulation No. 90 requires that all notices to agents or brokers that their contract or account is to be terminated contain the prescribed redlining wording, clearly and prominently set out in boldface type, or other manner, which draws the readers attention.

It was found during this examination that some of the termination notices issued by the Company were not being mailed or delivered to the affected agent or broker at least 30 days prior to the effective date of such termination. In addition, it was found that the redlining notice was not set out in the notices of termination of agents' contracts as required by Part 218.5 of Regulation No. 90.

In correspondence dated March 11, 2004, the Company agreed to comply with Regulation 90 in the future. Nevertheless, it is recommended that when sending out notices of termination of agents' or brokers' contracts or accounts, the Company ensure that all of the requirements of this Department's Regulation No. 90 are complied with, henceforth. It is noted that a similar recommendation was included in the prior report.

Section 2314 of the Insurance Law

During the review of the Company's rating practices it was found that the Company was not adhering to the rating rules it had in effect for minimum premiums for fire and extended coverage under Commercial Multiple Peril policies ("CMP") in some cases.

Section 2314 of the New York Insurance Law states, in part, that "No authorized insurer shall...charge or demand a rate or receive a premium which departs from the rates, rating plans, classifications, schedules, rules and standards in effect on behalf of the insurer..."

In correspondence dated February 13, 2004 the Company indicated that it had taken corrective action regarding this matter. Nevertheless, it is recommended that the Company comply with Section 2314 of the New York Insurance Law by charging rates that do not depart from the rates, rating plans, classifications, schedules, rules and standards it has in effect.

Department Regulation 154

Department Regulation 154 Part 19.4 requires insurers to report on a quarterly basis specified information relative to homeowners insurance policies. During the review of the Regulation 154 reports submitted by the Company to the New York Insurance Department it was found that they contained inaccuracies.

During the course of this examination the Company was requested to re-file the quarterly reports covering 2002 and the first two quarters of 2003. In correspondence dated January 23, 2004 the Company indicated that it was unable to re-file corrected Regulation 154 reports covering the period of time requested. In addition, the Company indicated that it had corrected its computer program and would be able to file accurate Regulation 154 reports in the future.

Nevertheless, it is recommended that the Company ensure that the reports it files to comply with the requirements of Department Regulation 154 are accurate in the future and that it

maintains the data necessary to reconstruct and correct future reports if inaccuracies are discovered in such reports.

15. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

| <u>Item</u> | <u>Page No.</u> |
|---|-----------------|
| A. <u>Management</u> | |
| i. Recommendation that the Company adhere to all the provisions of its charter and by-laws, henceforth. | 5 |
| The Company has not complied with this recommendation. See Section 2(A) of this report. | |
| ii. Recommendation that the Company adhere to the provisions of Section 712 of the New York Business Corporation Law in the future. | 5 |
| The Company has complied with this recommendation as of December 31, 2002. | |
| B. <u>Holding Company System</u> | |
| i. Recommendation that the Company comply with Section 1603(a) of the New York Insurance Law regarding prior notice if it decides to acquire any additional subsidiaries in the future. | 10 |
| The Company has substantively complied with this recommendation. | |
| ii. Recommendation that the Company comply with all the provisions of Department Regulation 53 and that it maintain and provide upon examination the records required by Section 1608(c) of the New York Insurance Law in order for the Company's compliance with Section | 10 |

| <u>Item</u> | <u>Page No.</u> |
|---|-----------------|
| 1608(b) of the New York Insurance Law to be determined. | |
| The Company has complied with part of the recommendation regarding Regulation 53. However, it has not complied with the part of the recommendation dealing with Section 1608. See Section 2(D) of this report. | |
| C. <u>Significant Operating Ratios</u> | 11 |
| Comment that the Company had six ratios fall beyond the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners, as of December 31, 1998. | |
| The Company has four IRIS ratio results as of December 31, 2002 that went beyond the industry benchmarks. See Section 2(E) of this report. | |
| D. <u>Abandoned Property</u> | 13 |
| Recommendation that the Company continue to file the reports with the state comptroller required by Section 1316 of the New York Abandoned Property Law and that it escheat amounts that have been outstanding longer than the required dormancy period. Additional recommendation that the Company maintain and provide upon examination the documentation needed to allow verification of the accuracy of the filings made with the State Comptroller's Office. | |
| The Company has substantively complied with these recommendations. | |
| E. <u>Allocation of Expenses</u> | 14 |
| Recommendation directing management to establish and maintain written | |

| <u>Item</u> | <u>Page No.</u> |
|---|-----------------|
| documentation supporting the allocation of each expense category to the major expense groups as required by Department Regulation 30. | |
| The Company has not complied with this recommendation. See Section 2(H)(iv) of this report. | |
| F. <u>Signature Requirements on Company Checks</u> | 14 |
| Recommendation that the Company comply with Section 6611(a)(4)(C) of the New York Insurance Law with regard to having the required number of officers' signatures on all Company checks. | |
| The Company has not fully complied with this recommendation. See Section 2(H)(v) of this report. | |
| G. <u>Approval of Investments</u> | 15 |
| Recommendation that the Company comply with the requirements of Section 1411(a) of the New York Insurance Law by having all of its investments authorized or approved as indicated in such section. | |
| The Company has not complied with this recommendation. See Section 2(H)(ii) of this report. | |
| H. <u>Valuation of Securities and Compliance with SVO certifications</u> | |
| i. Recommendation that the Company follow the NAIC guidelines for obtaining values of securities not listed in the NAIC's "Valuation of Securities" publication. | 16 |
| The Company has complied with this recommendation. | |
| ii. Recommendation that the Company comply with the statements | 16 |

| <u>Item</u> | <u>Page No.</u> |
|--|-----------------|
| <p>contained in the SVO Compliance Certification in the future.</p> <p>The Company has complied with this recommendation.</p> | |
| I. <u>Custodianship of Securities</u> | 17 |
| <p>Recommendation that the Company comply with Department Circular Letter No. 2 (1977) and only allow its investments to be held under custodial arrangements that meet the requirements put forth in the circular letter.</p> <p>The Company has not complied with this recommendation. See Section 2(H)(vii) of this report.</p> | |
| J. <u>Compliance with Section 1209(f) of the New York Insurance Law</u> | 17 |
| <p>Recommendation that the Company comply with Section 1209(f) of the New York Insurance Law.</p> <p>As of December 31, 2002 the Company was in compliance with Section 1209(f) of the New York Insurance Law.</p> | |
| K. <u>Accounts and Records</u> | |
| <p>i. Recommendation that the Company develop a written disaster recovery plan, standards manuals (system design, programming, and documentation) and a standard manual for operation in order to strengthen its electronic data processing function controls. Additional recommendation that the Company develop plans to continue operations in the event of the sudden departure or prolonged unexpected absence of key administrative and data processing employees in order to protect the best interests of the Company's policyholders.</p> | 18 |

| <u>Item</u> | <u>Page No.</u> |
|---|-----------------|
| <p>The Company did not provide a standard operations procedures manual and a documentation standards manual. See Section 2(H)(i) of this report. The Company substantively complied with the other sections of the recommendation.</p> | |
| <p>ii. Recommendation that the Company maintain the records required, in the form required, by Section 6611(b) of the New York Insurance Law and provide same upon examination.</p> <p>The Company has complied with this recommendation.</p> | 19 |
| <p>iii. Recommendation that the Company complete all financial statements filed with this Department in accordance with such statement's instructions, henceforth.</p> <p>The Company has not complied with this recommendation. See Section 2(H)(viii) of this report.</p> | 19 |
| <p>iv. Recommendation that the Company take the steps necessary to ensure that its records are maintained in such a manner as to fully and truly show its condition and to facilitate the verification of its financial statements filed with this Department as required by Section 6611(a)(1) of the New York Insurance Law.</p> <p>The Company substantively complied with the recommendation.</p> | 20 |
| <p>L. <u>Other Invested Assets</u></p> <p>Recommendation that the Company depreciate its leasehold improvements over a period of time not more than the term of the lease as required by the</p> | 24 |

| <u>Item</u> | <u>Page No.</u> |
|--|-----------------|
| <p>Department's conditions and that it report the depreciated value of such improvements, not the acquisition value, in future financial statements filed with this Department.</p> <p>The Company did not own any leasehold improvements as of December 31, 2002.</p> | |
| <p>M. <u>Agents' balances or uncollected premiums</u></p> <p>Recommendation that the Company comply with the requirements of this Department's unnumbered circular letter dated November 29, 1978, in determining overdue premiums and that it set forth actual amounts in future financial statements to the Superintendent, rather than estimated figures.</p> <p>Due to codification, effective January 1, 2001, this recommendation became moot.</p> | 25 |
| <p>N. <u>Electronic data processing equipment</u></p> <p>Recommendation that the Company depreciate any electronic data processing apparatus and related equipment reported as an admitted asset in its financial statements filed with this Department, as required by Section 1301(a)(18) of the New York Insurance Law.</p> <p>The Company has complied with this recommendation.</p> | 26 |
| <p>O. <u>Equities and deposits in pools and associations</u></p> <p>i. Recommendation that in future financial statements filed with this Department the Company include its gross equity in the New York Property Insurance Underwriting Association ("Fair Plan") in the asset,</p> | 27 |

| <u>Item</u> | <u>Page No.</u> |
|---|-----------------|
| <p>“Equities and deposits in pools and associations”.</p> <p>The Company has complied with this recommendation.</p> | |
| <p>ii. Recommendation that the Company comply with Department Circular Letter No. 13 (1975) and incorporate, on a direct basis, its proportionate share of the New York Property Insurance Underwriting Association in with its own business on an account by account basis in all future financial statements filed with this Department.</p> <p>Department Circular Letter No. 13 (1975) was withdrawn, but SSAP No. 63 has similar requirements, which the Company has not complied with. See Section 2(H)(vi) of this report.</p> | 28 |
| <p>P. <u>Premium deposits to reinsurer</u></p> <p>Recommendation that the Company account for any premiums related to its reinsurance contracts, either due to or due from its reinsurers, as part of the ceded reinsurance balances payable amount, which is to be offset against agents’ balances or uncollected premiums, as prescribed by the NAIC’s “Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies”, in future financial statements filed with this Department.</p> <p>Ceded reinsurance balances payable is now a separate liability on page 3 of the annual statement; therefore, the recommendation is moot.</p> | 29 |

| <u>Item</u> | <u>Page No.</u> |
|--|-----------------|
| <p>Q. <u>Losses and Loss adjustment expenses</u></p> <p>Recommendation that the Company increase its carried loss and loss adjustment reserves by the amount of the deficiency noted in this report and reflect such increase in future financial statements filed with this Department.</p> <p>Additional recommendation that the Company establish the necessary procedures so as to provide a more accurate reserve for unpaid losses and loss adjustment expenses (allocated and unallocated) in all future financial statements filed with this Department in order to comply with the requirements of Section 1303 of the New York Insurance Law.</p> <p>The Company has substantively complied with the recommendation to increase its loss and loss adjustment reserves by the amount of the deficiency noted in the prior report. The Company has not complied with the recommendation to comply with Section 1303 of the New York Insurance Law. See Section 8 of this report.</p> | 31 |
| <p>R. <u>Other expenses (excluding taxes, licenses and fees)</u></p> <p>Recommendation that the Company comply with Section 1306 of the New York Insurance Law and include an adequate reserve for all its unpaid expenses in future financial statements filed with this Department.</p> <p>The Company substantively complied with the recommendation.</p> | 33 |
| <p>S. <u>Market Conduct Activities</u></p> <p>i. Recommendation that the Company comply with the requirements of Section 2307(b) of the New York Insurance Law, by filing all of the</p> | 35 |

| <u>Item</u> | <u>Page No.</u> |
|---|-----------------|
| forms it uses with this Department, henceforth. | |
| The Company has complied with the recommendation. | |
| ii. Recommendation that the Company comply with all the provisions of Section 3403 of the New York Insurance Law and Department Regulation 96, henceforth. | 35 |
| The Company has complied with the recommendation. | |
| iii. Recommendation that when sending out notices of termination of agents' or brokers' contracts or accounts, the Company ensure that all of the requirements of Department Regulation 90 are complied with, henceforth. | 36 |
| The Company has not complied with the recommendation. See Section 14 of this report. | |
| iv. Recommendation that the Company comply with the requirements of Section 2112(a) of the New York Insurance Law by ensuring that all agents it is doing business with, are currently appointed with the Department. | 37 |
| The Company substantively complied with the recommendation. | |
| v. Recommendation that the Company comply with all the provisions of Department Regulation 64, henceforth. | 37 |
| The Company has complied with the recommendation. | |
| vi. Recommendation that the Company comply with all the provisions of Section 3425 of the New York Insurance Law, henceforth. | 38 |

| <u>Item</u> | <u>Page No.</u> |
|---|-----------------|
| The Company has complied with the recommendation. | |
| vii. Recommendation that the Company comply with the provisions of the New York Standard Mortgagee Clause and Department Circular Letter No. 17 (1976). | 39 |
| The Company has complied with this recommendation. | |
| viii. Recommendation that the Company comply with all the provisions of Department Circular Letter No. 11 (1978). | 39 |
| The Company has complied with this recommendation. | |

16. SUMMARY OF COMMENTS AND RECOMMENDATIONS

The following is a summary of comments and recommendations made in the body of this report:

| <u>Item</u> | <u>Page No.</u> |
|---|-----------------|
| A. <u>Management</u> | 5 |
| It is recommended that the Company adhere to all the provisions of its charter and by-laws, henceforth. It is noted that a similar recommendation was included in the previous report on examination. | |
| B. <u>Holding Company System</u> | 9 |
| It is recommended that the Company maintain and provide upon examination the records required by Section 1608(c) of the New York Insurance Law in order for the Company's compliance with Section 1608(b) of the New York Insurance Law to be determined. It is noted that a similar recommendation | |

| <u>Item</u> | <u>Page No.</u> |
|---|-----------------|
| was included in the previous report on examination. | |
| C. <u>Significant Operating Ratios</u> | 10 |
| It is noted that the Company had four ratios fall beyond the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners, as December 31, 2002. The two prior reports also indicated that the Company had ratio results that fell beyond the benchmark ranges. | |
| D. <u>Loans to Officers and Directors– Section 1411(f)(1)</u> | 11 |
| It is recommended that the Company comply with the requirements of Section 1411(f)(1) of the New York Insurance Law and not make loans to officers or directors. | |
| E. <u>Accounts and Records</u> | |
| i. <u>General System Controls</u> | 12 |
| It is recommended that the Company develop a standard operations procedures manual and a documentation standards manual in order to strengthen its electronic data processing function controls. It is noted that a similar recommendation was included in the previous report on examination. | |
| ii. <u>Approval of Investments</u> | 12 |
| It is recommended that the Company comply with the requirements of Section 1411(a) of the New York Insurance Law by having all of its investments authorized or approved as indicated in such section. It is noted that a similar recommendation was included in the previous report on | |

| <u>Item</u> | <u>Page No.</u> |
|--|-----------------|
| examination. | |
| iii. <u>CPA Contracts</u> | 13 |
| It is recommended that the Company ensure that its contracts with its CPA firm covering all future audit years meet the requirements of Department Regulation 118. | |
| iv. <u>Allocation of Expenses</u> | |
| a. Management is directed to establish and maintain written documentation supporting the allocation of each expense category to the major expense groups as required by this Department's Regulation No. 30. It is noted that a similar recommendation was included in the previous report on examination. | 13 |
| b. It is recommended that the Company allocate its expenses to each expense category in accordance with Department Regulation 30. | 14 |
| v. <u>Signature Requirements on Company Checks</u> | 14 |
| It is recommended that, henceforth, the Company comply with Section 6611(a)(4)(C) of the New York Insurance Law with regard to having the required number of officers' signatures on all Company checks. It is noted that a similar recommendation was included in the previous report on examination. | |
| vi. <u>Equities and Deposits in Pools and Associations</u> | 15 |
| It is recommended that the Company comply fully with SSAP No. 63 paragraph 8 and record premiums, losses, expenses and other operations of pools and associations separately in the financial statements and not net them | |

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| <p>against each other. A similar recommendation was made in the prior examination report regarding the separate recording of the Company's portion of premiums, losses, expenses and other operations of pools and associations.</p> | |
| vii. <u>Custodianship of Securities</u> | 16 |
| <p>It is recommended that the Company comply with Department Circular Letter No. 2 (1977) and only allow its investments to be held under custodial arrangements that meet the requirements put forth in the circular letter. It is noted that a similar recommendation was included in the previous report on examination.</p> | |
| viii. <u>Compliance with the Annual Statement Instructions</u> | 17 |
| <p>It is recommended that the Company complete all financial statements filed with this Department in accordance with such statement's instructions, henceforth. It is noted that a similar recommendation was included in the previous report on examination.</p> | |
| F. <u>Cash</u> | 23 |
| <p>It is recommended that the Company classify cash, cash equivalents and short-term investments in accordance with Statement of Statutory Accounting Principles No. 2, Issue paper No. 28 and the annual statement instructions.</p> | |
| G. <u>Receivable for Securities</u> | 24 |
| <p>It is recommended that the Company follow the requirements of SSAP 21 and the annual statement instructions relative to recording proceeds from the sale of investments that have not been received.</p> | |

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| H. <u>Agents' Balances or Uncollected Premiums</u> | 25 |
| <p>It is recommended that the Company comply with Sections 1301(a)(11) and (12) of the New York Insurance Law and with SSAP No. 6 paragraph 9 by not admitting agents' balances or uncollected premiums that are over 90 days past due.</p> | |
| I. <u>Losses and Loss Adjustment Expenses</u> | 26 |
| <p>It is recommended that the Company increase its carried loss and loss adjustment reserves by the amount of the deficiency noted in this report and reflect such increase in future financial statements filed with this Department. In addition, it is recommended that the Company provide an adequate reserve for unpaid losses and loss adjustment expenses in all future financial statements filed with this Department in order to comply with the requirements of Section 1303 of the New York Insurance Law. A similar recommendation was included in the prior report on examination.</p> | |
| J. <u>Other Expenses (excluding taxes, licenses and fees)</u> | 27 |
| <p>It is recommended that the Company not take admitted asset credit for pre-paid expenses as required by Section 1302(a)(2) of the New York Insurance Law.</p> | |
| K. <u>Unearned Premiums</u> | 29 |
| <p>It is recommended that the Company comply with Section 1305(a) of the New York Insurance Law by maintaining reserves equal to the unearned portions of the gross premiums charged on unexpired or unexpired risks</p> | |

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| and policies. It is also recommended that the Company comply with SSAP No. 53 by recording written premiums on the effective date of the contracts. | |
| L. <u>Advance Premiums</u> | 30 |
| It is recommended that the Company comply with SSAP No. 53 paragraph 13 and the annual statement instructions and show premiums received prior to the effective date of the contract as a liability and not as an offset to agents' balances or uncollected premiums. | |
| M. <u>Remittances and items not allocated</u> | 31 |
| It is recommended that the Company comply with SSAP No. 67 paragraph 9 and the annual statement instructions and show cash receipts that cannot be identified for a specific purpose or, for other reasons, applied to a specific account when received under the liability caption Remittances and items not allocated instead of as a write-in liability. | |
| N. <u>Market Conduct Activities</u> | |
| i. It is recommended that when sending out notices of termination of agents' or brokers' contracts or accounts, the Company ensure that all of the requirements of this Department's Regulation No. 90 are complied with, henceforth. It is noted that a similar recommendation was included in the prior report. | 32 |
| ii. It is recommended that the Company comply with Section 2314 of the New York Insurance Law by charging rates that do not depart from the rates, rating plans, classifications, schedules, rules and standards it has in | 33 |

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- effect.
- iii. It is recommended that the Company ensure that the reports it files to comply with the requirements of Department Regulation 154 are accurate in the future and that it maintains the data necessary to reconstruct and correct future reports if inaccuracies are discovered in such reports.

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Appointment No 22069

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:

Warren Youngs

as proper person to examine into the affairs of the

North Country Insurance Company

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

Company

with such other information as he shall deem requisite.

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

this 23rd day of June, 2003



A handwritten signature in black ink, appearing to read "Gregory V. Serio".

GREGORY V. SERIO
Superintendent of Insurance

Respectfully submitted,

15/
Warren Youngs
Associate Examiner

STATE OF NEW YORK)

) ss:

COUNTY OF ALBANY)

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

15/
Warren Youngs
Associate Examiner

Sworn to before me this

14 TH day of OCTOBER, 2004

15/
Notary Public

DIANNE M. BURKE
Notary Public, State of New York
Qualified in Albany County
No. 013U5076509 2007
Commission Expires April 21, 2008