

REPORT ON EXAMINATION
OF THE
SALEM MUTUAL TOWN FIRE INSURANCE COMPANY
AS OF
DECEMBER 31, 2002

DATE OF REPORT:

JULY 24, 2003

EXAMINER:

NYANTAKYI AKUOKO



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

George E. Pataki
Governor

Gregory V. Serio
Superintendent

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 22071 dated June 23, 2003, attached hereto, I have made an examination into the condition and affairs of the Salem Mutual Town Fire 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 244 Rexleigh Road, Salem, New York 12865.

Wherever the designations "the Company", or "SMTFIC" appear herein without qualification, they should be understood to indicate the Salem Mutual Town Fire Insurance Company.

Table of Contents

	<u>Page No.</u>
1. Scope of examination	2
2. Description of Company	2
A. Management	2
B. Territory and plan of operation	4
C. Reinsurance	5
D. Holding company system	6
E. Significant operating ratios	6
F. Abandoned property	7
G. Accounts and Records	7
3. Financial Statements	10
A. Balance sheet	10
B. Underwriting and investment exhibit	11
4. Loss and loss adjustment expense reserve	12
5. Market conduct activities	12
6. Compliance with prior report on examination	13
7. Summary of comments and recommendations	13

1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1997. This examination covered the five-year period from January 1, 1998 through December 31, 2002 and was limited in its scope to a review or audit of only those balance sheet items considered by this Department to require analysis, verification or description, including: invested assets, inter-company balances, loss and loss adjustment expense reserves and the provision for reinsurance. The examination included a review of income, disbursements and company records deemed necessary to accomplish such analysis or verification.

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

2. DESCRIPTION OF COMPANY

The Company was organized as the Salem Mutual Town Fire Insurance Company on February 23, 1889, for the purpose of transacting business as an assessment co-operative fire insurance company in the Town of Salem in New York State.

On August 11, 1971 and August 28, 1973, amended licenses were issued by this Department authorizing the Company to transact business as an assessment co-operative fire insurance company in Clinton, Essex, Fulton, Montgomery, Rensselaer, Saratoga, and Warren counties.

A. Management

The corporate powers of the Company is vested in a board consisting of eleven directors, divided into three groups as nearly equal as possible, one group being elected at each annual policyholders' meeting for a term of three years.

Each person insured by the Company is entitled to one vote in person at each of its annual meetings and no one may vote by proxy. The annual meeting of the board of directors is held immediately after the annual meeting of the Company. The board holds at least three additional meetings during each calendar year. A director must be a member of the Company and a resident of the territory in which the Company is authorized to transact business. During the period under review, the board met four times in each calendar year to comply with Section 6624(b) of the New York Insurance Law.

In the last quarter of 2002, a director passed away. Consequently, as of December 31, 2002, the board of directors consisted of the following ten members:

<u>Directors</u>	<u>Principal Business Affiliation</u>
Neil Adams Shusan, NY	Farmer
William Fleming Salem, NY	Farmer
Charles Gilchrist Shusan, NY	Farmer
Dean Hanks Salem, NY	Vice President, SMTFIC & Farmer
Donna MacNeil Salem, NY	Secretary/Treasurer, SMTFIC
Douglas Maxwell Cambridge, NY	Farmer
Donald McEachron Salem, NY	Farmer

<u>Directors</u>	<u>Principal Business Affiliation</u>
Harold McEachron Salem, NY	Retired Farmer
John Neil Salem, NY	President of SMTFIC
John Rich Shusan, NY	Hardware store owner

The Company's by-laws requires that eleven members shall constitute the board of directors hence, subsequent to December 31, 2002, a new member was elected to fill the vacancy created by the deceased director and to comply with the provisions of the by-laws.

The minutes of all meetings of the Board of Directors held during the examination period were reviewed. The average attendance by the board of directors was approximately 86%, with each individual director's attendance, except two, being adequate at these meetings. The two delinquent directors had ceased to be members as of December 31, 2002.

Each of the directors' qualifications, as set forth in Article II Section 1 of the Company's by-laws, were reviewed, and each director is duly qualified.

The following is a list of the Company's officers, as of December 31, 2002:

President	John Neil
Vice President	Dean Hanks
Secretary/Treasurer	Donna MacNeil

B. Territory and Plan of Operation

As of December 31, 2002, the Company was authorized to write insurance within Washington, Rensselaer, Saratoga and Warren Counties of the State of New York. The following schedule represents the direct premiums written by year:

<u>Calendar Year</u>	<u>Direct Premiums Written</u>
1998	\$25,333
1999	25,052
2000	25,151
2001	14,965
2002	14,166

As of December 31, 2002, the Company was authorized to transact the kinds of insurance defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law:

<u>Paragraph</u>	<u>Kinds of Business</u>
4	Fire
5	Miscellaneous property
6	Water damage
7	Burglary and theft
8	Glass

Based upon the lines of business for which the company is licensed, and pursuant to the requirements of Article 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 underwrites predominantly fire insurance, which accounted for 80% of the 2002 direct premium writings.

C. Reinsurance

The Company had no assumed reinsurance premiums written as of December 31, 2002. The Schedule F as contained in the Company's annual statements filed for the years within the examination period was found to accurately reflect its reinsurance transactions. The examiner reviewed the ceded reinsurance contract on file during the examination period. The contract, as

endorsed during the examination, contained the required standard clauses, including insolvency clause, meeting the requirements of Section 1308 of the New York Insurance Law.

As of December 31, 2002, the Company had the following reinsurance program in place:

Property	Five times the Company's net retention of \$14,000, subject to a maximum cession of \$70,000, each risk with a \$500 deductible
Windstorm	A net retention of \$3,000, subject to a maximum cession of \$81,000 each risk: with a \$500 deductible.

D. Holding Company System

The Company was not a member of any holding company system, as of December 31, 2002.

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	.012 to 1
Liabilities to liquid assets	0.00%
Premiums in course of collection(net of ceded balances payable) to surplus as regards policyholders	0.00%

The above ratios fall within the acceptable 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 from January 1, 1998 to December 31, 2002:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$40,046	45.3%
Other underwriting expenses incurred	68,663	77.7%
Net underwriting gain(loss)	<u>(20,376)</u>	<u>(23.0%)</u>
Premiums earned	<u>\$88,333</u>	<u>100%</u>

The Company received, for the period under examination, an exemption from the expense limitations imposed by Section 6613 of the New York State Insurance Law.

F. Abandoned Property Law

A review was made of the information included in the Company's reports of abandoned property to the Office of the Comptroller of the State of New York, during the period under examination. It was noted that the Company made the required filings for all the years under examination pursuant to Section 1316 of the New York Abandoned Property Law.

G. Accounts and Records

i. Custodial Agreement

As indicated in the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook, there are specific guidelines that should be followed in the maintenance of a custodial or safekeeping agreement. After a review of the Company's current custodial agreement, it was noted that several provisions and safeguards required by the NAIC and reinforced by the Department's Circular Letter No. 2 of 1997 were not found in the agreement. Therefore, it is recommended that the Company comply with NAIC requirements, reinforced by Circular Letter No. 2 of 1997 and obtain a custodial agreement that includes the requirements specified by the NAIC and the New York Insurance Department.

ii. Amortization of Bonds Purchased at Discount or Premium

SSAP No. 26 paragraph 7 states in part, “bonds... shall be reported at amortized cost.”

A review of the statement values of the Company’s bonds indicated that the book/adjusted values, as reported on Schedule D Part 1, were not amortized. Therefore, it is recommended that the Company comply with SSAP No. 26 paragraph 7 by reporting bonds at amortized cost.

iii. Limitation of Investments

Section 1409(a) of NYIL states in part, “... no domestic insurer shall have more than ten percent of its admitted assets as shown by its last statement on file with the Superintendent invested in or loaned upon, the securities of any one institution.” The Company’s money market funds held in Glen Falls Trust exceeded ten percent of the company’s admitted assets as reported in the 2002 annual statement. It is therefore, recommended that the company comply with the provisions of Section 1409(a) of NYIL by limiting its investment in any one institution, (except classes of governmental obligations set forth in Section 1409(b) and (c).

iv. Accounting

The money market funds account held by the Company as of December 31, 2002 was classified as cash on Schedule E Part 1 of the annual statement. As indicated in the annual statement instructions, a money market fund should be classified as a common stock. It is, therefore, recommended that the Company comply with the annual statement instructions and report the money market funds on Schedule D Part 2 Section 2 of the annual statement. No examination change will be made, as the amount is not material in relation to the Company’s surplus.

v. Regulation 30

The NYCRR Part 109.2 (Regulation 30) states in part, “ salaries of individuals or similarly employed groups shall be allocated direct to companies, expense groups and primary lines of business Such records shall be readily available for examination.” The Company, apparently, did not keep records on time and expense allocation; hence it could not provide the examination with any record. It is recommended that the Company comply with the NYCRR 109.2 (Regulation 30) by allocating time and expenses to the various expense groups and keeping records for verification.

3. FINANCIAL STATEMENTS

A. Balance sheet

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

<u>Assets</u>	Ledger <u>Assets</u>	Not-Admitted <u>Assets</u>	Net Admitted <u>Assets</u>
Bonds	\$ 76,845	\$-0-	\$ 76,845
Cash on hand and on Deposit	697,501	-0-	697,501
Agents' Balances or Uncollected premiums	19	-0-	19
Interest, dividends, and real Estate income due and accrued	<u>472</u>	<u>-0-</u>	<u>472</u>
Total Assets	\$774,837	\$ -0-	\$774,837
 <u>Liabilities & Surplus</u>			
Losses and loss adjustment expenses			\$ -0-
Other expenses due and accrued			-0-
Taxes, licenses and fees			268
Unearned premium			<u>4,311</u>
Total liabilities			4,579
Required Surplus		\$100,000	
Unassigned Funds		<u>670,258</u>	
Surplus as regards policyholders			<u>\$770,258</u>
Total			<u>\$774,837</u>

The Internal Revenue Service did not audit the Company's federal income tax returns during the period under examination. 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 increased \$123,755 during the five-year examination period, January 1, 1998 through December 31, 2002. The following is a condensed statement of the underwriting and investment results:

Statement of Income

Underwriting Income

Premiums earned		\$ 88,333
Losses and loss adjustment expenses incurred	\$40,046	
Other underwriting expenses incurred	<u>68,663</u>	
Total underwriting deductions		<u>108,709</u>
Net underwriting gain(loss)		\$ (20,376)

Investment Income

Net investment income earned	\$144,203	
Net realized capital gain	<u>-0-</u>	
Net investment gain(loss)		144,203
Net income before dividends to policyholders and federal; and foreign income taxes		\$123,827
Less: Dividends to Policyholders		-0-
Net income before federal and foreign income taxes		\$123,827

Federal and foreign income taxes incurred	<u>-0-</u>
Net income(loss)	<u>\$123,827</u>

Capital and Surplus Account

Surplus as regards policyholders, December 31, 1997, per prior Report on examination			\$646,505
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income or loss	\$123,827	\$-0-	
Net unrealized capital losses	-0-	(72)	
Change in non-admitted assets	-0-	-0-	
Total gains and losses	<u>\$123,827</u>	<u>\$ 72</u>	
Net increase in surplus			\$123,755
Surplus as regards policyholders per report on examination, as of December 31, 2002			\$770,260

4. LOSS AND LOSS ADJUSTMENT EXPENSE RESERVE

This examination included a review of the Company's loss register to determine the existence of any outstanding claims and any trends in the reporting of incurred but not reported losses. The Company reported liability of \$0 which is the same as the amount reported as the examination liability.

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.

The Department's analysis indicated that, in the aggregate, the Company's losses and loss adjustment expense reserves were adequate.

5. MARKET CONDUCT ACTIVITIES

During the course of this examination, a review was made of the manner in which the Company conducts its business and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the more precise scope of a market conduct investigation, which is the responsibility of the Market Conduct Unit of the Property Bureau. This examination's general review was directed at practices of the Company in the following areas:

- A. Sales and advertising
- B. Underwriting
- C. Rating
- D. Claims
- E. Cancellations
- F. Complaint procedures

No unfair practices were found.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>Item</u>	<u>Page No.</u>
A. It was recommended that the Company resolve to amend all subject accounts and specify that funds are payable upon the signature of at least two officers.	7

The Company has complied with this recommendation.

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

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

Item	Page No.
<u>A. Custodial Agreement</u>	7
It is recommended that the Company comply with NAIC Requirements, reinforced by Circular Letter No. 2 of 1997 and obtain a custodial agreement that includes the requirements	
<u>B. Amortization of Bonds Purchased at Discount or Premium</u>	8
It is recommended that the Company comply with SSAP No. 26 Paragraph 7 by reporting bonds purchased at discount or premium at amortized cost.	
<u>C. Limitation of Investments</u>	8
It is recommended that the Company comply with the provisions of Section 1409(a) of NYIL by limiting its investment in any one institution, (except classes of governmental obligations set forth in Section 1409(b) and (c).	
<u>D. Accounting</u>	8
It is recommended that the Company comply with the annual statement Instructions and report the money market funds on Schedule D Part 2 Section 2 of the annual statement.	
<u>E. Regulation 30</u>	9
It is recommended that the Company comply with the NYCRR 109.2 (Regulation 30) by allocating time and expenses to the various expense groups and keeping records for verification.	

Respectfully submitted,

 /5/
Nyantakyi Akwoko
Senior Insurance Examiner

STATE OF NEW YORK)
)SS.
)
COUNTY OF ALBANY)

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

 /5/
Nyantakyi Akwoko

Subscribed and sworn to before me

this 3rd day of July 2003

 /5/ *Clare*

ANDREA M. CLARE
Notary Public, State of New York
Qualified in Montgomery County
No. 4636585
Commission Expires July 31, ~~19~~2006

Appointment No 22071

*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:

Nyantaki Akuoko

as proper person to examine into the affairs of the

Salem Mutual Town Fire 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", written over a horizontal line.

GREGORY V. SERIO
Superintendent of Insurance