



**REPORT ON EXAMINATION
OF
PREFERRED MUTUAL INSURANCE COMPANY
AS OF DECEMBER 31, 2021**

**EXAMINER:
DATE OF REPORT:**

**EMILIE BRADY
FEBRUARY 2, 2023**

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KATHY HOCHUL
Governor



ADRIENNE A. HARRIS
Superintendent

February 2, 2023

Honorable Adrienne A. Harris
Superintendent
New York State Department of Financial Services
Albany, New York 12257

Madam:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 32344 dated June 9, 2022, attached hereto, I have made an examination into the condition and affairs of Preferred Mutual Insurance Company as of December 31, 2021, and submit the following report thereon.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate Preferred Mutual Insurance Company.

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

1. SCOPE OF EXAMINATION

The Department has performed an examination of Preferred Mutual Insurance Company, a multi-state insurer. The previous examination was conducted as of December 31, 2016. This examination covered the five-year period from January 1, 2017, through December 31, 2021. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

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

This examination report includes, but is not limited to, the following:

- Company history
- Management and control
- Territory and plan of operation
- Reinsurance
- Holding company description
- Financial statement presentation
- Loss review and analysis
- Significant subsequent events
- Summary of recommendations

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

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

2. DESCRIPTION OF COMPANY

Preferred Mutual Insurance Company was organized in 1896 as the Preferred Mutual Fire Insurance Company of Chenango County, for the purpose of transacting business as a cooperative fire insurance corporation in Chenango County, New York. On December 27, 1910, a certificate was issued under the provisions of the New York Insurance Law, authorizing the Company to continue the transaction of business on the advance premium plan in ten counties of New York. On July 6, 1936, the Company became authorized to transact business within the entire state of New York. On November 27, 1939, the Company was authorized to issue non-assessable policies.

In January 1952, the Company's charter was further amended to allow for the transaction of business, wherever authorized by law, in any other state and the District of Columbia. The Company adopted its current title on March 7, 1957.

A. Corporate Governance

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than seven nor more than 25 members. The board meets four times during each calendar year. At December 31, 2021, the board of directors was comprised of the following 12 members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Matthew T. Cooney, Jr. Solomons, MD	President (Retired), Cooney Communications Corp.
William C. Craine Sherburne, NY	Treasurer, Chenango County
Martin A. Dietrich Norwich, NY	NBT Bancorp Chairman (Retired), NBT Bank, N.A.
David B. Emerson Oxford, NY	Chairman of the Board (Retired), Blueox Corporation
Patrick J. Flanagan Norwich, NY	Attorney at Law, Nelson & Flanagan
Michael J. Hayduk Clinton, NY	Deputy Director, Information Directorate, Air Force Research Laboratory

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Heidi M. Hoeller Lakeville, CT	Partner (Retired), PricewaterhouseCoopers
Mary Ellen Luker New Hartford, NY	Principal, Fust Charles Chambers LLP
John C. Mitchell Ithaca, NY	President (Retired), I.L. Richer Company, Inc.
Rip L. Reeves Newfoundland, NJ	Chief Investment Officer and Treasurer, Aegis Insurance Services, Inc.
Christopher P. Taft Clinton, NY	President and Chief Executive Officer, Preferred Mutual Insurance Company
Robert A. Wadsworth Fishers Landing, NY	Chairman of the Board, Preferred Mutual Insurance Company

As of December 31, 2021, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Christopher P. Taft	President and Chief Executive Officer
Timothy R. Hyle	Senior Vice President, Chief Financial Officer and Treasurer
Andrew P. Forstenzer	Vice President and Secretary

B. Territory and Plan of Operation

As of December 31, 2021, the Company was licensed to write business in New York as well as in Connecticut, Massachusetts, New Hampshire, New Jersey, North Carolina, Ohio, Pennsylvania, Rhode Island, and South Carolina.

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

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

Based upon the lines of business for which the Company is licensed and the Company's current capital structure, and pursuant to the requirements of Articles 13, 41, and 66 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$1,450,000.

The following schedule shows the direct written premiums and premiums assumed by the Company for the period under examination:

<u>Calendar Year</u>	<u>Direct Premiums</u>	<u>Assumed Premiums</u>	<u>Total Gross Premiums</u>
2017	\$322,178,462	\$386,463	\$322,564,925
2018	\$338,615,203	\$475,641	\$339,090,844
2019	\$345,911,332	\$624,600	\$346,535,932
2020	\$305,696,202	\$689,823	\$306,386,024
2021	\$286,516,179	\$575,275	\$287,091,454

The Company writes personal and commercial property and casualty coverages in four states. In 2021, direct written premiums were derived from New York (56.0%), Massachusetts (23.7%), New Jersey (19.3%), and New Hampshire (1.0%). In 2021, homeowners multiple peril accounted for 36.7% of its direct writings, followed by automobile (35.9%), and commercial multiple peril (20.3%). Regarding its automobile insurance, the Company writes both personal and commercial business in New York and Massachusetts; in New Jersey and New Hampshire, the Company writes commercial, but not personal automobile insurance. The Company maintains relationships with 520 agency partners and 835 independent agents.

There was a decrease in the premium written from 2019 to 2020 due to the Company's re-evaluation of relationships with agents. In an effort to acquire a more desirable and stable business, the Company reduced the number of agents and agencies in which it conducted business, which in turn reduced the amount of premium written.

The Company's assumed reinsurance business consists of its participation in various mandated pools. The Company also services assigned risks pursuant to the Limited Assignment Distribution ("LAD") service agreements in New York and Massachusetts.

C. Reinsurance Ceded

The Company has structured its ceded reinsurance program as follows:

<u>Type of Treaty</u>	<u>Cession</u>
<u>Property Quota Share</u> (Auto excluded)	The Company cedes 15% all business reinsured up to a maximum cession of \$90,000 (being 15% of \$600,000) each loss, each risk. The Reinsurer's liability any one Loss Occurrence is 150% of the ceded Gross Net Written Premium Income.
<u>Property Per Risk Excess of Loss</u> (Auto excluded) Two layers	\$4,400,000 excess of \$600,000 each loss each risk, with occurrence limits of \$1,200,000 and \$12,000,000 each occurrence in layers one and two, respectively.
<u>Property Automatic Facultative</u> (Auto excluded)	\$20,000,000 excess of \$5,000,000 each loss, each risk.
<u>Property Cat Excess of Loss</u> Five layers	Layers 1 to 4: \$145,000,000 excess of \$10,000,000 each loss occurrence with a \$290,000,000 contract year limit in respect of all loss occurrences. 5 th Layer: \$50,000,000 excess of \$155,000,000 each loss occurrence with a \$100,000,000 contract year limit in respect of all loss occurrences.
<u>Casualty Excess of Loss</u> Two layers	\$6,500,000 excess of \$500,000 each loss occurrence.
<u>Umbrella – Commercial Lines Quota Share and Excess of Loss</u> Two layers	1 st Layer: 90% of the first \$1,000,000 each occurrence/\$1,000,000 aggregate.

	2 nd Layer: 100% excess of \$1,000,000 to policy limit \$5,000,000 policy limit/occurrence and aggregate.
<u>Umbrella – Personal Lines Quota Share and Excess of Loss</u> Two layers	1 st Layer: 90% of the first 90% of the first \$1,000,000 each occurrence/\$1,000,000 aggregate. 2 nd Layer: 100% excess of \$1,000,000 to policy limit \$5,000,000 policy limit/occurrence and aggregate.
<u>Commercial Lines Equipment Breakdown</u>	100% of \$50,000,000 of equipment breakdown liability for any one accident.
<u>Personal Lines Equipment Breakdown and Service Line</u>	100% quota share of \$100,000 of equipment breakdown for any one risk. 100% of \$10,000 of service line liability for any one risk.
<u>Commercial Cyber Liability</u>	100% quota share of all business reinsured subject to a maximum endorsement limit of \$1,000,000 per claim and \$1,000,000 in the aggregate, any one endorsement.

A majority of the cessions were to authorized reinsurers. It is the Company's policy to obtain the appropriate collateral for its cessions to unauthorized reinsurers. Letters of credit obtained by the Company to take credit for cessions to unauthorized reinsurers were reviewed, on a sample basis, for compliance with Department Regulation No. 133. As of December 31, 2021, the Company reported no significant reinsurance recoverables from any one reinsurer that were material to surplus.

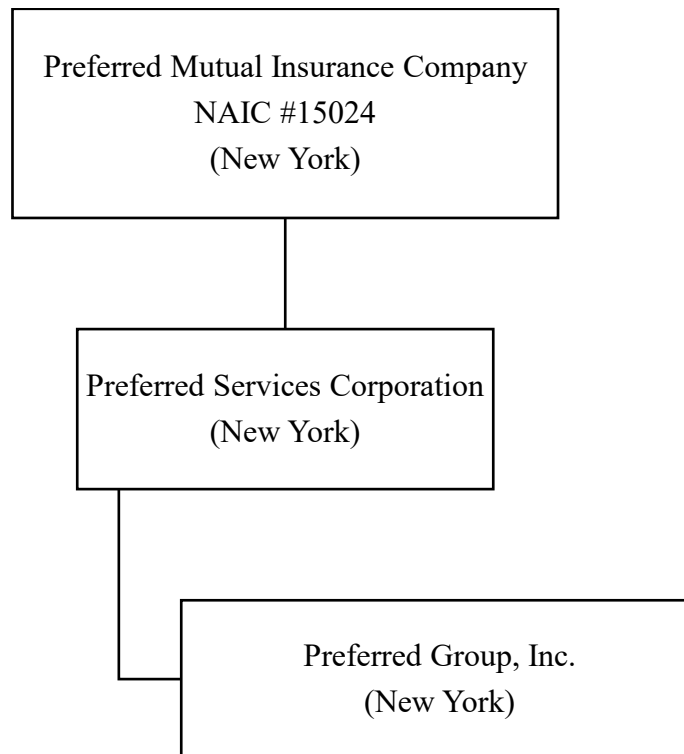
Examination review found that the Schedule F data reported by the Company in its filed annual statement accurately reflected its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in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

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

D. Holding Company System

The Company wholly-owns Preferred Services Corporation (“PSC”), a holding company incorporated in New York, which in turn wholly-owns Preferred Group, Inc. (“PGI”). PGI is a licensed agent of the Company. Both PSC and PGI were inactive during the examination period.

The following is an unabridged depiction of the holding company system at December 31, 2021:



Holding Company Agreements

The Company had the following inter-company agreements in effect as of December 31, 2021:

Technical Service Agreement Between the Company and PSC and PGI

The Company entered into a technical service agreement with PSC and PGI (collectively the “Subsidiaries”), effective January 1, 2002, whereby the Company will provide all insurance and administrative duties for each of the two companies. As the Subsidiaries were inactive during the examination period, there were no payments made pursuant to this agreement during the examination period.

Tax Allocation Agreement Between the Company and PSC and PGI

The Company entered into a tax allocation agreement, effective January 1, 2008, with PSC and PGI whereby the Company files a consolidated annual federal income tax return with its Subsidiaries. The agreement requires that each subsidiary prepare and furnish to the Company a computation of its federal tax liability as if each subsidiary had filed separate federal tax returns for the consolidated return year. The Subsidiaries are then required to pay the Company an amount equal to the federal taxes shown as due on the separate returns within thirty days following the filing of the consolidated federal tax return of the Group.

The Company is subject to the requirements of Article 16 of the New York Insurance Law and Department Regulation No. 53. A review of the annual filings made pursuant to Department Regulation No. 53 during the examination period indicated that such filings were complete and filed in a timely manner.

E. Significant Ratios

The Company's operating ratios, computed as of December 31, 2021, fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the NAIC.

<u>Operating Ratio</u>	<u>Result</u>
Net premiums written to policyholders' surplus	89%
Adjusted liabilities to liquid assets	60%
Two-year overall operating	92%

Underwriting Ratios

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

	<u>Amount</u>	<u>Ratio</u>
Losses and loss adjustment expenses incurred	\$ 838,867,150	68.26%
Other underwriting expenses incurred	\$ 441,365,732	35.92%
Net underwriting gain (loss)	\$ <u>(51,318,469)</u>	<u>(4.18)%</u>
Premiums earned	<u>\$1,228,914,413</u>	<u>100.00%</u>

The Company's reported risk-based capital ("RBC") score was 894.6% at December 31, 2021. The RBC score is a measure of the minimum amount of capital appropriate for a reporting entity to support its overall business operations in consideration of its size and risk profile. An RBC score of 200% or below can result in regulatory action. There were no financial adjustments in this report that impacted the Company's RBC score.

F. Accounts and Records

On May 15, 2003, the Department approved the Company's request to issue a fixed/floating rate surplus note in the amount of \$10,000,000 to I-Preferred Team Securities IV, Ltd. and to enter into an indenture with U.S. Bank Association as trustee for I-Preferred Team Securities IV, Ltd. The interest rate from May 15, 2003, to May 15, 2008, was a rate of 7.35%, and each succeeding interest payment was based on the 3-month LIBOR plus 4.10%. The note was issued on May 15, 2003, with a thirty-year duration. On June 19, 2019, the Department approved the principal and final interest payment on the surplus note. The Company made the final payment on August 12, 2019.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2021, as reported by the Company:

Assets

	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$450,718,847	\$ 0	\$450,718,847
Common stocks	45,445,266	0	45,445,266
Properties occupied by the company (less \$0 encumbrances)	4,355,101	0	4,355,101
Cash, cash equivalents, and short-term investments	35,419,611	0	35,419,611
Receivables for securities	41,504	0	41,504
Investment income due and accrued	3,064,607	0	3,064,607
Uncollected premiums and agents' balances in the course of collection	487,227	48,249	438,978
Deferred premiums, agents' balances and installments booked but deferred	55,215,187	5,000	55,210,187
Amounts recoverable from reinsurers	4,451,231	0	4,451,231
Current federal and foreign income tax recoverable and interest thereon	4,524,097	0	4,524,097
Net deferred tax asset	6,986,382	0	6,986,382
Furniture and equipment, including health care delivery assets	179,135	179,135	0
Cash surrender value	18,182,887	0	18,182,887
Equity in fair plans	13,185,044	0	13,185,044
Prepaid expenses	24,003,388	24,003,088	0
NJ prop/liab guaranty recoup	315,039	0	315,039
Equities and deposits in pools and associations	<u>120,000</u>	<u>0</u>	<u>120,000</u>
Total assets	<u>\$666,694,552</u>	<u>\$24,235,771</u>	<u>\$642,458,781</u>

Liabilities

Losses and loss adjustment expenses	\$206,661,430
Reinsurance payable on paid losses and loss adjustment expenses	30,949
Commissions payable, contingent commissions and other similar charges	10,264,937
Other expenses (excluding taxes, licenses and fees)	6,387,308
Taxes, licenses and fees (excluding federal and foreign income taxes)	58,511
Unearned premiums	128,027,540
Advance premium	2,316,702
Ceded reinsurance premiums payable (net of ceding commissions)	2,099,981
Funds held by company under reinsurance treaties	20,000
Amounts withheld or retained by company for account of others	20,951,716
Provision for reinsurance	29,000
Payable to parent, subsidiaries and affiliates	171,979
Payable for securities	439,700
Credits due to policyholders	<u>361,944</u>
 Total liabilities	 \$377,821,697

Surplus and Other Funds

Special contingent surplus	\$ 1,450,000
Unassigned funds (surplus)	<u>263,187,084</u>
 Surplus as regards policyholders	 <u>\$264,637,084</u>
 Totals liabilities, surplus and other funds	 <u>\$642,458,781</u>

Note: The Internal Revenue Service has not audited tax returns covering tax years 2017 and through 2021. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Statement of Income

The net income for the examination period as reported by the Company was \$45,049,973, as detailed below:

Underwriting Income

Premiums earned		\$1,228,914,413
Deductions:		
Losses and loss adjustment expenses incurred	\$838,867,150	
Other underwriting expenses incurred	434,847,134	
NY/LAD service agreement	<u>6,518,598</u>	
Total underwriting deductions		<u>1,280,232,882</u>
Net underwriting gain or (loss)		\$ (51,318,469)

Investment Income

Net investment income earned	\$ 58,678,867	
Net realized capital gain	<u>21,595,043</u>	
Net investment gain or (loss)		\$ 80,273,910

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$(1,171,439)	
Finance and service charges not included in premiums	20,055,803	
Aggregate write-ins for miscellaneous income	<u>2,353,621</u>	
Total other income		\$ <u>21,237,985</u>
Net income before federal and foreign income taxes		\$ 50,193,426
Federal and foreign income taxes incurred		<u>5,143,455</u>
Net income		\$ <u>45,049,973*</u>

* There is an immaterial difference of \$2 due to rounding.

C. Capital and Surplus

Surplus as regards policyholders increased \$30,011,003 during the five-year examination period January 1, 2017, through December 31, 2021, as reported by the Company, detailed as follows:

Surplus as regards policyholders, as reported by the Company as of December 31, 2016			\$234,626,081
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$45,049,973		
Net unrealized capital gains or losses	3,965,854		
Change in net deferred income tax		\$ 306,308	
Change in nonadmitted assets		6,154,420	
Change in provision for reinsurance	68,072		
Change in surplus notes		10,000,000	
Prior period adjustment	<u>0</u>	<u>2,612,168</u>	
Total gains and losses	\$49,083,899	\$19,072,896	
Net increase (decrease) in surplus			<u>30,011,003</u>
Surplus as regards policyholders, as reported by the Company as of December 31, 2021			<u>\$264,637,084</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$206,661,430 is the same as reported by the Company as of December 31, 2021. The examination analysis of the loss and loss adjustment expense reserves was conducted in accordance with actuarial standards of practice and statutory accounting principles, including SSAP No. 55. The majority of the Company's reserves are attributable to commercial multiple-peril and private passenger automobile liability.

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

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

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A. <u>Ceded Reinsurance</u> It was recommended that the Company comply with Section 1308(e)(1) of the New York Insurance Law, by submitting to the Department for prior approval, a summary of its ceded reinsurance program if total ceding premiums will exceed 50% of its prior year end unearned premiums.</p>	7

The Company has complied with this recommendation.

6. **SUMMARY OF COMMENTS AND RECOMMENDATIONS**

This report on examination does not contain any comments or recommendations.

Respectfully submitted,

_____/S/_____
Emilie Brady, CFE
Noble Consulting Services

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

Emilie Brady, being duly sworn, deposes and says that the foregoing report, subscribed by her, is true to the best of her knowledge and belief.

_____/S/_____
Emilie Brady

Subscribed and sworn to before me

this _____ day of _____, 2023.

NEW YORK STATE

DEPARTMENT OF FINANCIAL SERVICES

I, Adrienne A. Harris, Superintendent of Financial Services of the State of New York, pursuant to the provisions of the Financial Services Law and the Insurance Law, do hereby appoint:

Emilie Brady

as a proper person to examine the affairs of the

Preferred Mutual Insurance Company

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

COMPANY

with such other information as she shall deem requisite.

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

this 9th day of June, 2022

*ADRIENNE A. HARRIS
Superintendent of Financial Services*

By:

Joan Riddell

*Joan Riddell
Deputy Bureau Chief*

