

REPORT ON EXAMINATION  
OF THE  
EXCESS LINE ASSOCIATION OF NEW YORK  
AS OF  
DECEMBER 31, 2007

DATE OF REPORT

November 4, 2011

EXAMINER

Shawn Jernigan

Appointment No 22763

STATE OF NEW YORK  
INSURANCE DEPARTMENT

I, ERIC R. DINALLO, Superintendent of Insurance of the State of New York, pursuant to the provisions of the Insurance Law, do hereby appoint:

*Shawn Jernigan*

*as proper person to examine into the affairs of the*

**Excess Lines Association of New York**

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

**Association**

*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 New York,*

*this 29<sup>th</sup> day of April 2008*



A handwritten signature in cursive script, appearing to read "Eric R. Dinallo".

ERIC R. DINALLO

*Superintendent of Insurance*

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NEW YORK STATE  
DEPARTMENT *of*  
FINANCIAL SERVICES

Andrew M. Cuomo  
Governor

Benjamin M. Lawsby  
Superintendent

November 4, 2011

Honorable Benjamin M. Lawsby  
Superintendent  
New York, NY 10004

Sir:

Pursuant to instructions contained in Appointment No. 22763, dated April 29, 2008, I have made an examination into the conditions and affairs of the Excess Lines Association of New York, as of December 31, 2007 and the following report thereon is respectfully submitted.

Whenever the designations "ELANY" or "The Association" appears herein without qualification, they should be understood to indicate the Excess Lines Association of New York.

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

The examination was conducted at ELANY's office located at One Exchange Plaza, 55 Broadway, 29<sup>th</sup> Floor, New York, New York 10006.

## 1. Scope of Examination

The Department's previous examination of ELANY was conducted as of December 31, 2003. This examination covered the four year period from January 1, 2004 through December 31, 2007.

The examination was conducted to ascertain the manner in which the Association conducts its business with regards to fulfilling its purpose as stated in Section 1 of Chapter 630 of the Laws of 1988; which is "... to facilitate and encourage compliance by its members (excess line brokers) with the laws of this state and the rules and regulations of the Superintendent relative to excess line insurance". The examination also reviewed the Association's performance with regards to carrying out its underlying purpose of 1) protecting persons seeking insurance in this state; 2) permitting excess line insurance to be placed with reputable and financially sound unauthorized insurers; and 3) protecting the revenues of this State.

A review was also made to ascertain what action was taken by ELANY with regards to the comments and recommendations contained in the prior Report on Examination.

This Report on Examination is confined to financial statements, internal controls and comments relative to matters which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

## 2. Overview of ELANY

### A. History

ELANY was established as a non-profit association pursuant to Chapter 630 of the Laws of 1988 and began operation on January 1, 1989.

The operating procedures of the administration of ELANY are governed by a Plan of Operation (Plan) approved by the Superintendent pursuant to Section 2130(c) of the New York Insurance Law.

## B. Membership

All excess line brokers licensed under Section 2105 of the New York Insurance Law are deemed members of ELANY pursuant to Section 2130(a) of the Insurance Law. The membership is ended with the termination of the broker's excess line license. When brokers become licensed as excess line brokers, the Department's Licensing Bureau notifies ELANY which in turn sends the new members an information package to assist them in performing their duties as excess line brokers.

### 3. Plan of Operation Review

#### A. Management

The Plan of Operation (Plan) as approved by the Superintendent governs the management of ELANY. The Plan has granted management of ELANY to a Board of Directors which consists of not less than five nor no more than nine persons who are elected to serve "three year non-concurrent terms". The Plan also states that the Board shall hold regular meetings at least quarterly as well as special meetings under certain conditions and/or emergencies.

As of December 31, 2007, the Board of Directors consisted of the following members:

<u>Name</u>	<u>Affiliation</u>
Donald Privett (Chairman)	Privett Special Risk Services, LLC
Kevin McGill (Vice Chairman & Treasurer)	Wells Fargo Insurance Services of New York Inc.
John A. Buckley (Secretary)	NIF Services on New York Inc.
Margaret Beirne	AON Group, Inc.
Joseph F. Caligiuri	Risk Placement Services Inc.
Thomas J. Derella	The Kingstar Company Inc.
Gary A. Hollederer	Russell Bond & Co. Inc.
Lee A. Orabona	Pacific Wholesale Insurance Brokers
Robert Shapiro	Global Facilities Inc.
David Isenburg (Immediate Past Chairman)	DC White Agency

There were 16 Board of Directors meetings during the examination period. These meetings were generally well attended.

B. Administration

The Plan provides that an Executive Officer shall be the chief operating officer of ELANY. The Executive Officer's duties shall be to implement the policies of the Board of Directors. The Plan also provides that ELANY may employ such persons, firms etc. as needed for the performance of the duties of ELANY.

As of December 31, 2007, the officers of ELANY were as follows:

<u>Name</u>	<u>Title</u>
Daniel F. Maher	Executive Director
Nancy Born	Office Manager
Theresa Hetherington	Stamping Office Manager
Richard Schlesinger	Financial Director
Eugene Nunziata	Education/Communications Director
Brian Persaud	IT Manager

#### 4. Financial Statements

The financial statements consist of a balance sheet reflecting the assets and liabilities as of December 31, 2007, and a statement of income for the period January 1, 2004 through December 31, 2007.

ELANY's financial statements were audited by a firm of certified public accountants. An unqualified opinion was rendered for every year of the examination period.

#### 5. ELANY Functions

##### A. Processing and Stamping of Affidavits

Pursuant to Section 2118(b)(1) of the Insurance Law, within 45 days after an excess line policy is procured, member brokers are required to submit to ELANY affidavits along with the policy declaration page or cover note (or binder in lieu of the declarations page or cover notes; with submission of the declaration page or cover notes upon receipt by broker) evidencing placements with unauthorized insurers. These documents are then reviewed by ELANY examiners for completeness and accuracy. If the submitted affidavit is not prepared properly or contains questionable information, the documents evidencing placement are returned unstamped to the broker for correction and/or additional explanation. Otherwise, the placement is recorded into ELANY's database and the policy declarations page or cover note is stamped and returned to the broker. The affidavits are also submitted to the Department in accordance with Section 2130(a)(4) of the Insurance Law. The member broker is then billed .2% of the reported premium for this stamping.

ELANY members submit the above mentioned affidavits and policy endorsements (changes) in groupings referred to as batches. From the varying populations listed in the chart on the next page, 60 batches were reviewed for each year during the examination period. The affidavit review focused on the timeliness of filing by the brokers and the adherence to Department Regulation 41 requirements.

Late Submissions

The following table contains a breakdown of the findings of the affidavit review:

	<u>Batch</u> <u>Populations</u>	<u>Batches</u> <u>Reviewed</u>	<u>Total</u> <u>Affidavits</u> <u>Reviewed</u>	<u>Late</u> <u>Affidavits</u>	<u>Percentage</u>
<b>2004</b>	42,131	60	298	16	5%
<b>2005</b>	42,768	60	268	25	9%
<b>2006</b>	43,022	60	311	12	4%
<b>2007</b>	45,334	60	329	16	5%
<b>Totals</b>	173,255	240	1206	69	6%

The percentages above in general mirror the late submission percentages stated in the minutes of Board of Directors meetings.

Declination Procedures

Unless a particular coverage is listed on the export list, an excess line broker is required to obtain three declinations from licensed insurers prior to the placement of a risk in the excess line market. A review of the declination information was included in the affidavit review above. The review of the declinations ascertained whether the notice of excess line placement dates preceded declination dates. Declinations were also reviewed to verify that they were received from legitimate authorized insurance companies.

The percentages for the previously mentioned reviews are as follows:

<u>Year</u>	<u>Notice of placement date</u> <u>precedes declination date</u>	<u>No placement</u> <u>date on</u> <u>affidavits</u>
2004	<1%	4%
2005	<1%	6%
2006	3%	18%
2007	3%	20%

Affidavit submissions with no placement dates do not allow examiners to make a determination as to whether the declination dates are before the excess line placement dates.

It is recommended that ELANY monitor the submission of the notice of the excess line placement form to ensure that the proper procedures with regards to declinations and the placement of coverage are adhered to in accordance with the New York Insurance Law and Regulation 41.

It is also recommended that ELANY contact those members who submit questionable and incomplete affidavits and provide them with appropriate training.

In addition, it is recommended that ELANY contact those members who submit affidavits/notice of excess line placement forms where the notice of excess line placement date or inception date precedes the declination date and provide those members with appropriate training.

Furthermore, it is recommended that ELANY verify the Association's "Declination Procedures", which includes ascertaining whether the notice of excess line placement/inception dates preceded declination dates, by conducting spot check audits and report the results of these audits to the Department's Excess Lines Unit.

#### B. Unauthorized Insurer Files

As part of the application process to be accepted as an eligible unauthorized insurer in New York, ELANY requires an unauthorized insurer intending to do business in New York to submit financial statements and other pertinent documentation for analysis and evaluation in accordance with Section 27.13 of Regulation 41. If ELANY determines that the insurer qualifies for eligibility, ELANY notifies the insurer in writing of its acceptance and places the insurer on ELANY's stamping list of eligible insurers. Once on the stamping list, eligible insurers are monitored for financial strength and viability and are subject to an annual re-qualification process.

However, if ELANY determines that an insurer does not qualify for eligibility, the insurer is notified of the said ineligibility. The insurer can later submit updated financial information and documentation to ELANY for its reconsideration.

A review of the unauthorized insurers' application files was conducted to determine whether ELANY has fulfilled its statutory obligations of admitting unauthorized insurers who are financially sound and has treated applicants fairly and equally. Through a review of the Board of Directors minutes, a listing was made of all companies which applied for the stamping list during the review period. A sample of companies which were either approved or rejected, was reviewed. It was determined that documentation was adequate; the files contained supporting evidence that an analysis of the financial information had been performed and that the review performed by ELANY on the submitted information was done consistently and fairly.

### C. Expenditures

#### Charitable and Non-charitable Contributions

On June 7, 2007 the Office of General Counsel (OGC) issued an opinion which discussed the permissibility of ELANY making *de minimis* charitable contributions. The opinion states that in the Department's estimation, Section 2130 of the Insurance Law, which created ELANY as a quasi-public entity, fails to provide ELANY with sufficient authority to make any contributions, except that in certain narrow parameters, *de minimis* charitable contributions may be considered to be "incidental or related" to ELANY's purposes. OGC therefore concluded that: (1) ELANY may make no charitable contributions whatsoever, except to an organization providing humanitarian aid in the wake of a natural disaster or terrorist act, or to an organization established by the insurance industry for charitable works; (2) ELANY must limit its total contributions to any given charitable organization to \$1,000 in any calendar year; (3) ELANY must limit its aggregate charitable contributions to \$15,000 in any calendar year; (4) ELANY must itemize each charitable contribution it made during the year under review in the annual audited statement that ELANY files with the Department, and specify the organization to whom the contribution was made, the date of the contribution, the amount of the contribution, and that nature and purpose of the gift; and (5) ELANY must ensure that its Board approves each donation, no matter what amount.

ELANY adhered to the above parameters for the year 2007. The Association made two separate \$1,000 charitable donations in 2007.

However, in 2006 and 2007, contributions of \$15,000 and \$25,000 respectively, were made by ELANY to the "Coalition Opposed to Federal Insurance Regulation" or COFIR. As the name suggests, COFIR is an advocacy/lobbying organization which represents companies and organizations that support the continuance of a state based system of insurance regulation and opposes the creation of a Federal insurance regulatory system. COFIR is not a charitable organization or an organization established by the insurance industry for charitable works, this contribution is outside of the narrow parameters outlined in the OGC opinion.

As such, it is recommended that going forward, ELANY adhere to the parameters set forth in the aforementioned OGC opinion.

#### D. Statement of Fund Balance / Stamping Fee

The prior report of examination indicated that ELANY's fund balance as of December 31, 2003 was \$9,940,703. ELANY's financial statements indicated that the fund balance as of December 31, 2007 was \$21,593,346, an increase of \$11,652,643 during the examination period. The \$21,593,346 exceeds the current operational needs of ELANY. In response to this, during the examination period, ELANY requested and received approval for, a reduction in stamping fee from .4% to .3%, effective July 1, 2004, and a further reduction from .3% to .2%, effective July 1, 2005.

The following table reflects the changes in annual revenues, expenses and fund balances during the examination period:

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Beginning Fund Balance	\$9,940,703	\$15,452,033	\$19,000,865	\$20,771,183
Total Revenues	\$9,963,961	\$8,207,997	\$6,351,985	\$6,521,731
Total Expenses	\$4,452,631	\$4,659,165	\$4,581,667	\$5,699,568
Excess of Revenues over Expenses	\$5,511,330	\$3,548,832	\$1,770,318	\$822,163
Ending Fund Balance	\$15,452,033	\$19,000,865	\$20,771,183	\$21,593,346

It is recommended the Board of Directors of ELANY continue to monitor the fund balance in order to assure that the accumulated fund balance will be able to satisfy the reasonable operational needs of ELANY.

#### E. Internal Controls

As part of the examination, the internal control procedures of ELANY were reviewed. The review revealed weaknesses in the internal control procedures specifically relating to segregation of duties and maintenance of authorization documentation.

##### a) Segregation of duties

The Office Manager is responsible for the authorization of expenditures, maintenance of accounting records and custody of assets. This violates the principle of segregation of duties

The last examination report recommended that a non-signatory perform ELANY's bank reconciliation. ELANY's response to this recommendation is for bank reconciliations to now be reviewed by the Education/Communications Director. However, bank reconciliations continue to be performed by the Office Manager (with verification by an outside consultant) in addition to her duties of maintaining accounting records.

The accounts receivable function is now prepared by the Administrative Assistant and overseen and posted by the Office Manager. It should be noted that there is direct line of authority between the Administrative Assistant and the Office Manager.

It is recommended that ELANY incorporate the principle of segregation of duties in order to ensure that ELANY's assets are safeguarded and its obligations and liabilities are properly authorized and recorded.

b) Maintenance of documentation of authorization

In response to the last examination report, ELANY reported that authorization of all vendor invoices / expenses are now approved for payment by approved signature of the Office Manager, IT Manager, Financial Director or Executive Director. Documentation of these authorizations is now maintained to allow accountability to management and broker members for its actions.

A review was conducted to ascertain if the new procedure is being properly adhered to. Documentation for 120 expense/voucher payments was requested from the Association. As part of this review, the documentation for 28 expense/voucher payments which were dated after ELANY's receipt of the previous report were examined to verify the presence of an approved signature on the documentation of each voucher. Twelve out of 28 vouchers had no approval signature. Also, an additional 12 out of 28 vouchers had an approval signature of the Office Manager, who also requisitioned payment for the vouchers.

In addition to the recommendation for ELANY to incorporate the principle of segregation of duties, it is also recommended that ELANY properly approve all authorization for expenses.

c.) Travel & Entertainment Guidelines

As part of the expense review mentioned above, expenses which pertained to payment for travel and entertainment expenses of ELANY personnel were reviewed to verify that ELANY's payment of these expenses were in accordance with Association guidelines. In accordance with the Travel and Entertainment Policy of ELANY, only expenses which are reasonable and necessary for the conduct of the Association's business are to be charged and reimbursed by ELANY. In addition, with regard to spousal / family travel, travel costs for family members other than the spouse are not reimbursable.

In reviewing the expenses presented for approval relating to ELANY's August 2007 Board of Directors meeting, it appeared that family member expenses were approved, which is not in compliance with the Association's travel and entertainment guidelines. In addition, other non business related expenses were also paid.

ELANY indicated that during one board meeting per year, family members of the board are invited to the meeting. Each Board member has a preset approved limit of \$500 on non business spending. This is not addressed in the Association's Travel & Entertainment guidelines.

It is recommended that ELANY adhere to its Travel & Entertainment guidelines and to update the written policy to clarify any exceptions to the present guidelines.

#### F. Binding Authority Agreements

Section 2118(f) of the Insurance Law states that, "an excess line broker licensed pursuant to Section 2105 of this article may execute an authority to bind coverage and may exercise binding authority on behalf of an insurer not licensed or authorized to do business in this state... and shall set forth the terms, conditions and limitations governing the exercise of binding authority by the excess line broker."

ELANY's procedures according to the Finance Director are to personally review the agreements, to send out an acceptance notice to the individual brokers whereby the onus is placed upon the broker to comply with their agreements, and to subsequently file them.

The binding authority questions in Section 2, Question 2(e), of the Part A Affidavit, "*Does the broker have binding authority?*" has been eliminated from the affidavit form as of January 1, 2007. Members are still required to file copies of each binding authority agreement with ELANY and to comply with each such agreement in accordance with the requirements of Regulation 41 as stated above.

## 6. Compliance with Prior Report on Examination

The following matters were the subject of recommendations in the prior Report on Examination (*page numbers shown refer to the prior Report*):

It should be noted that items B, C, D and F below are recommendations which ELANY has failed to implement.

<u>Item</u>	<u>Page No.</u>
<p>A. It was recommended that ELANY continue to promote member compliance with the provisions of Section 2118(b)(1) of the Insurance Law. It is also recommended that ELANY notify the Department when brokers persistently fail to submit affidavits within 45 days of inception date of the policy.</p> <p>ELANY has complied with this recommendation.</p>	9
<p>B. It was recommended that any affidavit where the notice of excess line placement date precedes the declination date is sent back to the broker for an explanation and that the Department be notified of any broker who continues to utilize such practice.</p> <p>ELANY has not complied with this recommendation.</p> <p>See section 7(C) of the Summary of Recommendations of this report.</p>	10
<p>C. It was recommended that any affidavit where the inception date precedes the declination date is sent back to the broker for an explanation and that the Department be notified of any broker who continues to utilize such practice.</p> <p>ELANY has not complied with this recommendation.</p> <p>See section 7(C) of the Summary of Recommendations of this report.</p>	10

D. It was recommended that ELANY contact those members who submit questionable affidavits and provide them with appropriate training. 10

ELANY has not complied with this recommendation.

See section 7(B) of the Summary of Recommendations of this report.

E. It was recommended the Board of Directors of ELANY continue to monitor the fund balance in order to assure that the accumulated fund balance will be able to satisfy the reasonable operational needs of ELANY. 14

ELANY has complied with this recommendation.

F. It was recommended that ELANY incorporate the principle of segregation of duties into appropriate job functions in order to ensure that ELANY's assets are safeguarded and its obligations and liabilities are properly authorized and recorded. 15

ELANY has not complied with this recommendation.

See section 7(G) of the Summary of Recommendations of this report.

G. It was recommended that ELANY properly record and maintain all documentation of authorization for expenses. 15

ELANY has complied with this recommendation.

H. It was recommended that ELANY review the job descriptions of its employees and rewrite or adapt them to meet the current needs of the Association. 15

ELANY has complied with this recommendation.

I. It was recommended that ELANY establish formal written internal control procedures. It is also recommended that ELANY provide the Department with a copy of the internal control report and steps taken by ELANY to alleviate any problems noted in the report. 15

ELANY has complied with this recommendation.

J. It was recommended that ELANY formalize the additional responsibilities of the Audit and Finance Committee in writing. 16

ELANY has complied with this recommendation.

K. It was recommended that ELANY implement procedures requiring its examiners to verify the existence of a binding authority agreement and that ELANY perform periodic review of the examiners work to ensure they are following such procedures. 16

As the binding authority agreement question has been removed from the affidavit, and no longer part of the examination process, this recommendation is not required.

## 7. Summary of Recommendations

The following summarizes the recommendations contained in this Report on Examination:

<u>Item</u>	<u>Page No.</u>
<p>A. It is recommended that ELANY monitor the submission of the notice of the excess line placement form to insure that the proper procedures with regard to declinations and the placement of coverage are adhered to in accordance with the New York Insurance Law and Regulation 41.</p> <p style="padding-left: 2em;">A similar recommendation was included in the prior report on examination.</p>	7
<p>B. It is recommended that ELANY contact those members who submit questionable and incomplete affidavits and provide them with appropriate training.</p> <p style="padding-left: 2em;">A similar recommendation was included in the prior report on examination</p>	7
<p>C. It is recommended that ELANY contact those members who submit affidavits/notice of excess line placement forms where the notice of excess line placement date or inception date precedes the declination date and provide those members with appropriate training.</p>	7
<p>D. It is recommended that ELANY verify the Association’s “Declination Procedures”, which includes ascertaining whether the notice of excess line placement/inception dates preceded declination dates by conducting spot check audits and report the results of these audits to the Departments Excess Lines Unit.</p>	7

E. It is recommended that going forward, ELANY adhere to the parameters set forth in the OGC opinion dated June 7, 2007 concerning charitable contributions. 9

F. It is recommended the Board of Directors of ELANY continue to monitor the fund balance in order to assure that the accumulated fund balance will be able to satisfy the reasonable operational needs of ELANY. 10

A similar recommendation was included in the prior report on examination.

G. It is recommended that ELANY incorporate the principle of segregation of duties in order to ensure that ELANY'S assets are safeguarded and its obligations and liabilities are properly authorized and recorded. 11

A similar recommendation was included in the prior report on examination.

H. It is recommended that ELANY properly approve all authorizations for expenses. 11

I. It is recommended that ELANY adhere to its Travel & Entertainment guidelines and to update the written policy to clarify any exceptions to the present guidelines. 12

Respectfully submitted,

Shawn Jernigan  
Senior Insurance Examiner

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

Shawn Jernigan, being duly sworn, deposes and says that the foregoing report submitted by him is true to the best of his knowledge and belief.

*Shawn Jernigan*  
Shawn Jernigan

Subscribed and sworn to before me  
this 26 day of July 2009.

EDDIE CLEMETSON  
Notary Public, State of New York  
No. 01CL5066654  
Qualified in Bronx County  
Commission Expires Sept. 30, 2010

*Eddie Clemetson*