

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

DATE OF REPORT

DECEMBER 19, 2003

EXAMINER

GEORGE BABU

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

December 19, 2003

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

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 22049 dated April 29, 2003 attached hereto, I have made an examination into the condition and affairs of Drivers Insurance Company as of December 31, 2002, and submit the following report thereon.

The examination was conducted at the Company's administrative offices located at 575 Jericho Turnpike, Jericho, New York 11753.

Wherever the designations "the Company" or "Drivers" appears herein without qualification, they should be understood to indicate Drivers Insurance Company.

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

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. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination comprised a complete 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 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 bond and other insurance
- Territory and plan of operation
- Growth of Company
- Business in force by states
- Loss experience
- Reinsurance
- Accounts and records
- Financial statements

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

Drivers Insurance Company was incorporated under the laws of New York State on January 26, 1995 as Spirit Insurance Company and commenced business on May 16, 1996. On December 6, 1999, the Company's name was changed to Drivers Insurance Company. The Company ceased writing business in 2000. On January 2, 2002, Tri-State Consumer, Inc. acquired 60% of its ownership in return for a surplus contribution of \$806,000. Penny Fern Hart and Dean Evan Hart each own 50 percent of Tri-State Consumer, Inc. Capital paid in is \$700,000 consisting of 100 shares of \$7,000 par value per share common stock. Gross paid in and contributed surplus is \$1,156,838. Gross paid in and contributed surplus increased by \$806,838 during the examination period, as follows:

<u>Year</u>	<u>Description</u>	<u>Amount</u>
2001	Beginning gross paid in and contributed surplus	\$350,000
2002	Surplus contribution	<u>806,838</u>
2002	Ending gross paid in and contributed surplus	<u>\$1,156,838</u>

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 thirteen members. The board met three times during calendar year 2002. At December 31, 2002, the board of directors was comprised of the following thirteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Penny F. Hart New York, NY	President and Treasurer, Drivers Insurance Company
Lynda Cruise Plainview, NY	Vice President and Secretary, Tri-State Consumer Insurance Company
Barbara Elis Syosset, NY	Vice-President, Tri-State Consumer Insurance Company
Dean Hart Jericho, NY	Optometrist, Woodbury Optical
Ronald Hart Tamarac, FL	Retired
Donna Hourigan Westbury, NY	Human Resources & Operations Manager, Tri-State Consumer Insurance Company
Murray Lemonik Valley Stream	Lawyer
Michael Lomelo Setauket, NY	Secretary, Drivers Insurance Company
Milo Pinckney St. Albans, NY	Marketing Consultant
Jeffrey Raff New York, NY	Investments, Morgan Keegan
John Rose Selden, NY	Senior Vice President, Drivers Insurance Company
David Schwartz Bay Terrace, NY	Investments & Owner, First Capital Equity
Richard Summer Hicksville, NY	Branch Manager, Haylor, Froyer & Coon

A review of the board of directors' meetings held during the period covered by this examination indicated that the meetings were generally well attended with exception of Mr. Dean Hart who did not attend any of the three meetings held during the year 2002 and Mr. Ronald Hart who attended only one meeting during the year 2002.

Members of the board have a fiduciary responsibility and must evince an on-going interest in the affairs of the insurer. It is essential that board members attend meetings consistently and set forth their views on relevant matters so that appropriate policy decisions may be reached by the board. Individuals who fail to attend at least one half of the board's regular meetings, unless appropriately excused, do not fulfill such criteria.

It is recommended that the board members who are unwilling to attend meetings consistently should resign or be replaced.

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

<u>Name</u>	<u>Title</u>
Penny F. Hart	President & Treasurer
John Rose	Senior Vice President
Michael Lomelo	Secretary

B. Territory and Plan of Operation

As of December 31, 2002, the Company was licensed to write business only in New York.

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>
13	Personal injury liability
14	Property damage liability
19	Motor vehicle and aircraft physical damage

Based on 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 and 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$700,000.

During the period under examination, the Company wrote private passenger auto liability and auto physical damage insurance coverage. In 2002, the Company wrote approximately \$1,505,499 of premiums through twenty-five licensed brokers, some of which are owned or controlled by officers and directors of the Company. Commissions paid on these premiums amounted to approximately \$63,673 in 2002.

C. Reinsurance

Assumed

The Company does not assume any reinsurance business.

Ceded

The Schedule F data as contained in the Company's filed annual statement was found to accurately reflect its reinsurance transactions.

The examiner reviewed the ceded reinsurance contract in effect at December 31, 2002. The contract contained the required standard clauses including insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

The Company had the following ceded reinsurance program in effect at December 31, 2002:

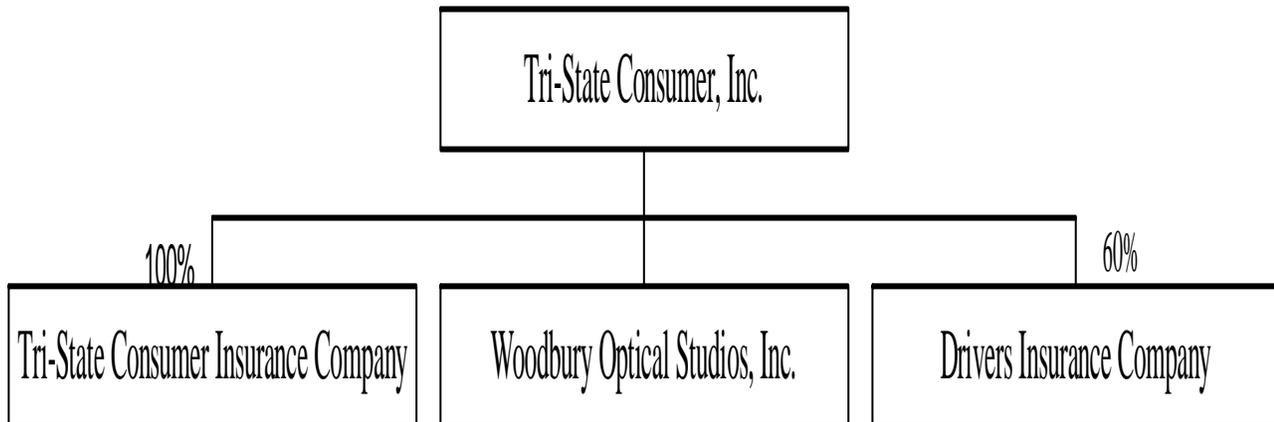
<u>Type of treaty</u>	<u>Cession</u>
Excess of Loss Multiple Line 100% Authorized	\$850,000 excess of \$150,000, as respect to any one occurrence.

D. Holding Company System

Tri –State Consumer, Inc. (“Parent”) acquired a 60% interest in the Company effective January 1, 2002. Penny Fern Hart and Dean Evan Hart each own 50% of the Parent. The remaining 40% of the Company’s outstanding stock is owned by outside shareholders.

A review of the holding company registration statement filed with this Department indicated that such filing was complete and was filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

The following is a chart of the holding company system as of December 31, 2002:



At December 31, 2002, the Company and Tri-State Consumer Insurance Company (“Tri-State”), a wholly owned subsidiary of the parent, were parties to the following agreements:

Management Agreement

Effective, January 1, 2000, Tri-State Consumer Insurance Company and Drivers entered into a management agreement. According to this agreement, Tri-State Consumer Insurance Company will be the manager for the Company. Drivers agreed to pay Tri-State a management fee of 14.5% of gross premium written in exchange for operational services including policy issuance, premium collection, claims adjustments, customer service, legal defense, data processing services and information technology. The agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law.

The management agreement states that the Company shall pay to Tri State full compensation for all services rendered a fee in the amount of 14.5% of gross written premium based on actual expenses incurred by Tri-State for each year. The examiner noted that the Company did not establish a “true-up” of its management expenses as required by the management agreement between Drivers and Tri-State.

It is recommended that the Company conduct a study as per Regulation 30 for the actual expenses incurred by Tri-State on behalf of Drivers and make necessary adjustments so that management fees reflect the actual costs of the services rendered in compliance with its filed service agreement on a regular and periodic basis.

Lease Agreement

The Company entered into a lease agreement with Tri-State Consumer Insurance Company effective January 1, 2002. This agreement was later amended as of September 1, 2002 and then as of May 15, 2003. During the review of this agreement, it was noted that the Company did not submit the lease agreement to the Department for approval pursuant to Section 1505 (d) (3) of the New York Insurance Law. At the examiner's request, the Company submitted the captioned agreement along with all the amendments thereto to the Department for approval on August 26, 2003. Ultimately, the Department found this agreement to be non-objectionable.

The Company's failure to file the amendment to the lease agreement at least thirty days prior to its effective date appears to be a violation of Section 1505(d)(3) of the New York Insurance Law.

E. Abandoned Property Law

Section 1316 of the New York State Abandoned Property Law provides that amounts payable to a resident of this state from a policy of insurance, if unclaimed for three years, shall be deemed to be abandoned property. Such abandoned property shall be reported to the comptroller on or before the first day of April each year. Such filing is required of all insurers regardless of whether or not they have any abandoned property to report. The Company did not make the required filings.

It is recommended that the Company comply with the Section 1316 of the New York Abandoned Property Law and file the applicable report in the future regardless of whether or not they have any abandoned property to report.

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 2002, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	1 to 1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	28%
Premiums in course of collection to surplus as regards policyholders	1%

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

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

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$1,561,803	70.94%
Other underwriting expenses incurred	1,174,325	53.34
Net underwriting loss	<u>(534,396)</u>	<u>(24.27)</u>
Premiums earned	<u>\$2,201,732</u>	<u>100.00%</u>

G. Disaster Recovery Plan

According to the Company's response to this Department's information systems internal control questionnaire, the Company has stated that it has a disaster recovery or contingency plan. This plan, however, has not been formalized. The purpose of a disaster recovery plan is to ensure that key personnel know their responsibility in the event of a disaster.

It is recommended that the Company develop a formal disaster recovery plan.

Subsequent to the completion of this examination, the Company drafted and adopted a formal disaster recovery plan.

H. Accounts and Records

1) Notes to Financial Statements

The Notes to Financial Statements indicate that the Company has 200 shares of common stock authorized, issued and outstanding with a par value of \$3500. The actual number of common shares is 100 with a \$7,000 par value per share.

It is recommended that due care management exercise in reporting financial disclosures while preparing annual financial statements.

2) Electronic Data Processing (“EDP”)

The Company reported non-operating system software of \$1,867 as an admitted asset on December 31, 2002. Section 1301(a) (18) of the New York Insurance Law states that electronic data processing equipment and related equipment should be considered as an admitted asset if the cost of such items exceed \$50,000.

It is recommended that the Company comply with the provisions of Section 1301(a)(18) of the New York Insurance Law for electronic data processing equipment and software and reflect electronic data processing equipment and software systems less than \$50,000 as not-admitted.

Regulation 30

The Company reported \$218,297 in management fees to Tri-State Consumer Insurance Company as “Net commission and brokerage” as Part 3 of the Underwriting and Investment Exhibit in its December 31, 2002 filed annual statement. All expenses were allocated to the “Other Underwriting Expenses” category.

Part 107.3 of Department Regulation 30 requires that expense classifications shall be allocated to the specified expense groups.

Paragraph 7 NAIC SSAP No. 70 “Allocation of Expenses” states:

“7. Many entities operate within a group where personnel and facilities are shared. Shared expenses, including expenses under the terms of a management contract, shall be apportioned to the entities incurring the expense as if the expense had been paid solely by the incurring entity. The apportionment shall be completed based upon specific identification to the entity incurring the expense. Where specific identification is not feasible apportionment shall be based upon pertinent factors or ratios.”

It is recommended that the Company undertake a study to determine the proper amounts to allocate between expenses classified pursuant to Department Regulation 30, Part 107.3 as well as Paragraph 7 of NAIC SSAP No. 70 and the annual statement instructions with respect to expense classification.

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:

<u>Assets</u>	<u>Examination</u>		
	<u>Assets</u>	Assets Not <u>Admitted</u>	Net Admitted <u>Assets</u>
Bonds	\$1,470,177	\$ 0	\$1,470,177
Cash and short-term investments	310,056	0	310,056
Premiums and agents' balances in course of collection	21,314	5,878	15,436
Premiums, agents' balances and installments booked but deferred and not yet due	698,099	0	698,099
EDP equipment and software	1,494	0	1,494
Interest, dividends and real estate income due and accrued	<u>17,906</u>	<u>0</u>	<u>17,906</u>
Total Assets	<u>\$2,519,046</u>	<u>\$5,878</u>	<u>\$2,513,168</u>

Liabilities, Surplus and Other FundsLiabilities

Losses		\$ 249,967
Loss adjustment expenses		45,175
Commissions payable, contingent commissions and other similar charges		14,935
Other expenses (excluding taxes, licenses and fees)		7,273
Taxes, licenses and fees (excluding federal and foreign income taxes)		(9,488)
Unearned premiums		873,566
Remittances and items not allocated		190
Payable to parent, subsidiaries and affiliates		<u>23,733</u>
Total liabilities		\$1,205,351

Surplus and Other Funds

Common capital stock	\$ 700,000	
Gross paid in and contributed surplus	1,156,838	
Unassigned funds (surplus)	<u>(549,022)</u>	
Surplus as regards policyholders		<u>1,307,816</u>
Total liabilities, surplus and other funds		<u>\$2,513,167</u>

Note: The Internal Revenue Service has not audited the Company's tax returns for tax year 2002. 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. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$492,064 during the five-year examination period January 1, 1998 through December 31, 2002, detailed as follows:

Underwriting Income

Premiums earned		\$ 2,201,732
Deductions:		
Losses incurred	\$ 846,016	
Loss adjustment expenses incurred	715,787	
Other underwriting expenses incurred	<u>1,174,325</u>	
Total underwriting deductions		<u>2,736,128</u>
Net underwriting gain or (loss)		\$ (534,396)

Investment Income

Net investment income earned	\$ 66,626	
Net realized capital gain	<u>(8,796)</u>	
Net investment gain or (loss)		257,830

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$ (184,490)	
Finance and service charges not included in premiums		
	<u>\$ 32,900</u>	
Total other income		<u>(151,590)</u>
Net income but before federal and foreign income taxes		\$ (428,156)
Federal and foreign income taxes incurred		<u>6,755</u>
Net Income		<u>\$ (434,911)</u>

C. Capital and Surplus Account

Surplus as regards to policyholders , December 31, 1997 , per examination			\$ 815,751
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income		\$434,911	
Net unrealized capital gains or (losses)		17,667	
Change in non-admitted assets	137,804		
Cumulative effect of changes in accounting principles			
Capital changes paid in		50,000	
Surplus adjustments paid in	<u>856,838</u>	<u> </u>	
Net increase (decrease) in surplus	<u>\$994,642</u>	<u>\$502,578</u>	<u>492,064</u>
Surplus as regards policyholders per report on examination as of December 31, 2002			<u>\$1,307,815</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$295,142, is the same as reported by the Company as of December 31, 2002. The Company began operations in January 2002 and did not have sufficient historical experience upon which to establish a reliable actuarial estimate of loss and loss adjustment expense reserve. The examiner reviewed claims activity in 2003 for losses and loss adjustment expenses incurred on or prior to December 31, 2002. It was determined that the reserves for losses and loss adjustment expenses, as established by the Company as of the examination date, were adequate.

5. MARKET CONDUCT ACTIVITIES

In 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 of this Department.

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

- A. Sales and advertising
- B. Underwriting
- C. Rating
- D. Claims and complaint handling

The examiner's limited sample of five claim payments revealed potential violations of Department Regulation No. 68 as follows:

	<u>No of Instances</u>	<u>Total Claims Sampled</u>
Application for Benefits sent late [Part 65 3.4 (b)]	2	5
Additional Verification forms requested within 15 business days [Part 65 3.5 (b)]	1	5
A second request for verification shall be sent within 10 calendar days for verifications not received 30 calendar days after the original mailing [Part 65 3.6 (b)]	2	5
Late Payment of Claims [Part 65 3.7]	4	5
Interest on Overdue Payments [Part 65 3.9]	1	5

It is recommended that the Company comply with the provisions of Part 65 of Department Regulation No. 68 when processing no-fault claims.

<u>ITEM</u>		<u>PAGE NO.</u>
C	<u>Audited Financial Statements</u>	
	It is recommended that in the future the Company enter into a written contract with its independent certified public accountant that confirms to the requirements of section 307 (b) of the New York Insurance Law and Department Regulation 118.	10-11
	The Company has complied with this recommendation.	
D	<u>Fidelity Bond</u>	
	It is recommended that the Company maintain fidelity bond coverage in an amount at least equal to the NAIC suggested minimum amount.	11
	The Company has complied with this recommendation.	
E	<u>Accounts and Records</u>	
	i. <u>Investments</u>	
	It is recommended that the Company maintain its investments at a licenses bank or trust company that meets the Department's guidelines.	11-12
	The Company has complied with this recommendation.	
	ii. <u>Schedule Y</u>	
	It is recommended that the Company adhere to the NAIC's annual statement instructions by completing Schedule Y, Parts 1 and 2 in future filings with the department.	12
	The Company has complied with this recommendation.	
F	<u>Loss and Loss Adjustment Expenses</u>	
	It is recommended that Spirit Insurance Company adhere to the NAIC's annual statement instructions when reporting loss and loss adjustment expense reserves in future filings with the department.	16
	The Company has complied with this recommendation.	

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>		<u>PAGE NO.</u>
A	<p><u>Management</u></p> <p><u>Board Meeting</u></p> <p>It is recommended that the board members who are unwilling to attend meetings consistently should resign or be replaced.</p>	5
B	<p><u>Holding Company System</u></p> <p>i. It is recommended that the Company conduct a study as per Regulation 30 for the actual expenses incurred by Tri-State on behalf of Drivers and make necessary adjustments so that management fees reflect the actual costs of the services rendered in compliance with its filed service agreement.</p> <p>ii. It is recommended that, in the future, the Company notify the Superintendent in writing at least thirty days prior to entering into transactions that fall within section 1505(d)(3) of the New York Insurance Law.</p>	8 9
C	<p><u>Abandoned Property Law</u></p> <p>It is recommended that the Company comply with the Section 1316 of the New York Abandoned Property Law and file the applicable report in the future regardless of whether or not they have any abandoned property to report.</p>	9
D	<p><u>Disaster Recovery Plan</u></p> <p>It is recommended that the Company develop a formal disaster recovery plan. Subsequent to the completion of this examination, the Company adopted a formal disaster recovery plan.</p>	11
E	<p><u>Accounts and Records</u></p> <p>i. <u>Notes to Financial Statements</u></p> <p>It is recommended that due care be exercised in reporting financial disclosures while preparing annual financial statements.</p>	11

<u>ITEM</u>		<u>PAGE NO.</u>
ii.	<u>Electronic Data Processing (EDP)</u>	
	It is recommended that the Company comply with the provisions of Section 1301(a)(18) of the New York Insurance Law for electronic data processing equipment and software and reflect EDP Equipment and software systems less than \$50,000 as not-admitted.	11
iii.	<u>Regulation 30, Part 3 – Expenses</u>	
	It is recommended that the Company undertake a study to determine the proper amounts to allocate between expenses classified pursuant to Department Regulation 30, Part 107.3 as well as Paragraph 7 of NAIC SSAP No. 70 and the annual statement instructions with respect to expense classification.	12
F	<u>Market Conduct Activities</u>	
	It is recommended that the Company comply with the provisions of Part 65 of Department Regulation No. 68 when processing no-fault claims.	18

Respectfully submitted,

George Babu

Senior Insurance Examiner

STATE OF NEW YORK)

)SS:

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COUNTY OF NEW YORK)

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

George Babu

Subscribed and sworn to before me

this _____ day of _____, 2004.

Appointment No 22049

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:

George Babu

as proper person to examine into the affairs of the

DRIVERS INSURANCE COMPANY

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

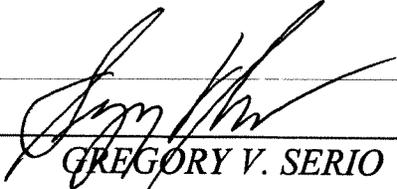
Company

with such other information as she shall deem requisite.

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

this 29th day of April, 2003





GREGORY V. SERIO
Superintendent of Insurance