

REPORT ON EXAMINATION

OF THE

OTSEGO COUNTY PATRONS CO-OPERATIVE FIRE RELIEF ASSOCIATION

AS OF

DECEMBER 31, 2003

DATE OF REPORT

FEBRUARY 24, 2006

EXAMINER

NYANTAKYI AKUOKO

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

February 24, 2006

Honorable Howard Mills  
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 22247 dated August 10, 2004 attached hereto, I have made an examination into the condition and affairs of Otsego County Patrons Co-operative Fire Relief Association as of December 31, 2003, and submit the following report thereon.

Wherever the designations "the Company" or "OCPCFRA " appear herein without qualification, they should be understood to indicate the Otsego County Patrons Co-operative Fire Relief Association.

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

The examination was conducted at the Company's home office located at 8146 State Highway 7, Schenevus, New York 12155.

## 1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1999. This examination covered the 4-year period from January 1, 2000 through December 31, 2003, and was limited in scope to these 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. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner. 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 was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

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

## 2. DESCRIPTION OF COMPANY

The Company was incorporated under the laws of the State of New York on November 8, 1913 as Otsego County Patrons Co-operative Fire Relief Association for the purpose of transacting business as an assessment co-operative fire insurance corporation in Otsego, Delaware, Schoharie and Greene counties of this State. Effective January 1, 1987, this Department approved the extension of the Company's writing powers to include the kinds of insurance specified in subsection (a) and (b) of Section 6605 of the New York Insurance Law ("NYIL").

### A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not less than nine directors nor more than fifteen members. At least four board meetings were held each year for the period under examination, thereby complying with Section 6624 (b) of the New York Insurance Law. At December 31, 2003, the board of directors was comprised of the following nine members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Richard C. Ballard, Sr. Morris, NY	Painter
Susan Bunyan Drake Cherry Valley, NY	Secretary/Treasurer, Otsego County Patrons Co-operative Fire Relief Association
Majorie M. French Schenevus, NY	Branch Manager, Wilber National Bank
Richard Lee Hanson Cooperstown, NY	President, Otsego County Patrons Co-operative Fire Relief Association; Self employed- Farmer/Greenhouse business
Lawrence Nelson Hickling Edmeston, NY	Dairy farmer
David C. Maine Edmeston, NY	Retired
Glen D. Marks Schoharie, NY	Retired
Elsie Turner Myers Davenport, NY	Vice President, Otsego County Patrons Co-operative Fire Relief Association, Insurance Agent and broker
Stephen A. Winters Garrattsville, NY	Vice President, Otsego County Patrons Co-operative Fire Relief Association

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member has an acceptable record of attendance. Each of the directors' qualifications, as set forth in Article II Section 1 of the Company's by-laws and Articles V & VI of its Charter, were reviewed, and each director was found to be duly qualified.

The Company did not provide formal minutes of the Nominating Committee meetings held during the examination period. Section 6611(a)(3) of the NYIL states that, "The secretary shall maintain a minute book recording the proceedings of all meetings of the corporation, its board of directors and the

principal committees thereof.” Therefore, it is recommended that the Company comply with Section 6611(a)(3) of the NYIL and maintain formal minutes of committee meetings.

During the examination review of the minutes of the board of directors’ meetings, it was noted that the Company violated several sections of its by-laws. Some of the violations included, but not limited to, the posting of the listing of members nominated for election, the time period for which the listing of nominated members should reach the secretary, and the election of an appraiser. Therefore, it is recommended that the Company adhere to all provisions of its by-laws.

Section 712(a) of the New York Business Corporation Law (“NYBCL”) gives the authority to create committees of the board to the board of directors. In 2002 and 2003, the board did not formally approve the appointments of members to committees. Therefore, it is recommended that the Company comply with Section 712(a) of the NYBCL regarding board approval of membership to committees.

During the course of the examination, it was discovered that the board of directors authorized an employee of the Company and a director to sign checks in 2002 and 2003 when neither the employee nor the said director were properly elected officers of the Company. It was also determined from a special examination conducted by the Department that a former officer of the Company was signing checks when their policy should have been cancelled for nonpayment, thus making them ineligible to be a director or an officer. Article III Section 1 of the Company’s by-laws, in effect at that time, required the officers of the Company to be members of the board.

Section 6611(a)(4)(C) of the New York Insurance Law requires, in part, that all checks shall be signed either by two officers or by one officer upon the written order of another officer. In view of the above, it is recommended that the Company comply with Section 6611(a)(4)(C) of the NYIL regarding signature requirements on checks.

The special examination conducted by the Department also discovered that a former officer, who is still a current director, signed blank checks and checks with payees listed but no amount entered. Sections 717(a) and 715(h) of the NYBCL put forth the fiduciary responsibilities of directors and officers, respectively. The sections indicate that a director or officer shall perform their duties as such in good faith and with that degree of care, which an ordinarily prudent person in a like position would use under similar circumstances.

Signing blank checks or signing checks with no amount entered is not the act of a prudent person. In addition, see Section 5 “Non-Payment of Premium and Cancellation of Policies” of this report for more information on an officer not fulfilling their fiduciary responsibilities.

Thus, it is recommended that, henceforth, the directors and the officers of the Company remain mindful of their fiduciary responsibilities to the Company and its policyholders, as set forth in Section 717(a) and 715(h) of the NYBCL. In addition, the Company is directed to replace any director and/or officer who cannot or does not fulfill their duties in good faith and with that degree of care, which an ordinarily prudent person in a like position would use under similar circumstances.

As of December 31, 2003, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Richard Lee Hanson	President
Susan Bunyan Drake	Secretary/Treasurer
Stephen A. Winters	First Vice President
Elsie Turner Myers	Second Vice President

B. Territory and Plan of Operation

As of December 31, 2003, the Company was licensed to write business in the following nineteen counties of New York State: Albany, Broome, Chenango, Columbia, Cortland, Delaware, Fulton, Greene, Herkimer, Madison, Montgomery, Oneida, Onondaga, Oswego, Otsego, Schenectady, Schoharie, Sullivan and Ulster. A review of the Company's premium database indicated that the Company wrote business in two counties, which it was not licensed in. Therefore, it is, recommended that the Company write only in the counties it has been licensed in pursuant to Section 6608(b) of the NYIL.

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
12	Collision
13	Personal injury liability
14	Property damage liability

<u>Paragraph</u>	<u>Line of Business</u>
15	Workers' compensation and employers' liability, (excluding workers' compensation)
19	Motor vehicle and aircraft physical damage (excluding aircraft physical damage)
20	Marine and inland marine (inland marine only)

The Company was also licensed as of December 31, 2003, to accept and cede reinsurance as provided in Section 6606 of the Insurance Law of the State of New York.

Based upon the lines of business for which the Company is licensed, and pursuant to the requirements of Articles 13 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 following schedule shows the direct premiums written by the Company in New York for the period under examination:

<u>Calendar Year</u>	<u>Direct Premiums Written (000's)</u>
2000	\$1,324
2001	\$1,371
2002	\$1,449
2003	\$1,600

The Company's predominant lines of business are homeowners multiple peril, commercial multiple peril and fire, which accounted for approximately 46%, 21% and 14%, respectively, of the Company's 2003 direct premium writings.

#### C. Reinsurance

##### Assumed

The Company did not assume any reinsurance business as of December 31, 2003.

##### Ceded

The Schedule F data as contained in the Company's filed 2003 annual statement was not found to accurately reflect its reinsurance transactions. The Company ceded reinsurance premiums to five

companies, but Schedule F Part 3 indicated one of the companies as the sole reinsurer. During the course of the examination, the Company prepared amended Schedule F Parts 3 and 5 that accurately reflected its reinsurance transactions.

The examiner reviewed all ceded reinsurance contracts in effect at December 31, 2003. The contracts all 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, 2003:

<u>Type of treaty</u>	<u>Cession</u>
Excess of Loss:	
Property (2 layers)	\$86,000 in excess of \$14,000, each risk, each occurrence, reinsurers liability shall not exceed \$172,000 per any one occurrence; except specified catastrophe perils such as windstorm, tornado, flood, etc. which is \$91,000 in excess of \$9,000 any one loss any one risk, reinsurers liability shall not exceed \$182,000 per any one occurrence.
	\$200,000 excess of \$100,000 any one risk; reinsurers liability shall not exceed \$400,000 any one occurrence.
Casualty (2 layers)	\$491,000 in excess of \$9,000 per occurrence.
Combined (Property and Casualty combined in one occurrence)	\$86,000 in excess of \$14,000 net loss on any one or more of the property classes of business and one or more of the casualty classes of business per occurrence.
Casualty clash	\$500,000 in excess of \$500,000 per occurrence.
Property Catastrophe Excess of Loss (2 Layers)	\$450,000 in excess of \$50,000 ultimate net loss each loss occurrence involving three or more risks.
	100% in excess of \$500,000 ultimate net loss each loss occurrence.

Aggregate Excess of Loss (Property and Casualty)	95% of the amount by which aggregate net losses for any one agreement year exceeds 65% of the net earned premium income during such agreement year, subject to a maximum recovery of 95% of \$400,000.
Special Casualty Excess of Loss	\$500,000 in excess of \$500,000 any one loss occurrence.

During the course of the examination, it was determined that the Company's net retention after reinsurance as of December 31, 2003, for casualty risks and specified catastrophe perils like windstorm, tornado, etc. on both a risk and an occurrence basis exceeded the limitations put forth by Section 6610(d) and (e) of the NYIL. Therefore, it is recommended that the Company comply with Sections 6610(d) and (e) of the NYIL and limit its net insurance on a single casualty risk and on a single risk and occurrence of specified catastrophe perils to the limitations put forth by Section 6610 of the NYIL. It is noted that a similar recommendation was included in the prior report on examination.

In addition to its treaty reinsurance program, the Company also obtained property facultative reinsurance coverage. The maximum cession for the program is 50% of gross liability or \$300,000, whichever is less; with risks over \$300,000 underwritten on an offer and acceptance basis.

Since the prior examination the Company's retention decreased from \$20,000 to \$14,000 on property business, from \$10,000 to \$9,000 on casualty business, while its retention on specified catastrophe perils (windstorm, etc.) increased from \$5,000 to \$9,000. In addition the \$20,000 annual aggregate deductible on property and specified catastrophe perils was removed from its contracts. The percentage of cessions to authorized reinsurers has decreased slightly compared with the prior examination period (see the Unauthorized Reinsurance section below).

### Unauthorized Reinsurance

A review of OCPCFRA's Property and Casualty Combination Excess of Loss Reinsurance contract that became effective January 1, 2003 showed that one participating reinsurer on the Property Catastrophe Excess of Loss and the Aggregate Excess of Loss sections, Farm Mutual Reinsurance Plan, was unauthorized. Section 6606(a)(2) of the New York Insurance Law states that "Unless otherwise permitted by the superintendent, an assessment corporation may assume reinsurance only from other authorized assessment corporations but may cede reinsurance to any other licensed insurer if such insurer

is authorized to reinsure such kind or kinds of insurance in this state or to an accredited reinsurer, as defined in subsection (a) of section one hundred seven of this chapter.” The Company’s transaction with an unauthorized reinsurer violates Section 6606(a)(2) of the New York Insurance Law. Thus, it is recommended that the Company comply with Section 6606(a)(2) by ceding to authorized or accredited reinsurers only, unless otherwise permitted by the superintendent. Currently it appears that as of December 31, 2003, no amounts were recoverable from the unauthorized reinsurer.

D. Holding Company System

As of December 31, 2003, the Company was not a member of any holding company system.

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.

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

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 2003 based upon the results of this examination:

Net premium written in 2003 to surplus as regards policyholders	1.18 to 1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	75%

Premiums in course of collection to surplus as regards policyholders	10.4%
Two-year overall operating ratio	118%*
Investment yield	1.9%*
Change in policyholders surplus	(29%)*

The above ratios denoted with an asterisk fall outside the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners. The three IRIS ratio failures are mainly due to net underwriting losses, decline in investment returns and negative net income over the four years covered by the examination.

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

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$1,697,219	103.17%
Other underwriting expenses incurred	574,191	34.90%
Net underwriting loss	<u>(626,264)</u>	<u>(38.07)%</u>
Premiums earned	<u>\$1,645,146</u>	<u>100.00%</u>

G. Accounts and Records

i. Approval of Investment transactions

During the course of the examination, it was discovered that the board of directors did not approve investment transactions as required by Section 1411(a) of the NYIL. It is therefore recommended that the Company comply with Section 1411(a) of the NYIL and have all investment transactions authorized or approved by the board of directors or a committee thereof responsible for supervising or making such investments.

#### ii. Compliance with the Annual Statement Instructions

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

- a. Section 2(C) "Reinsurance"
- b. Section 2(G)(iii) "Misclassification of annual statement line items"
- c. Section 4 "LOSSES AND LOSS ADJUSTMENT EXPENSES"

Therefore, it is recommended that, the Company complete all financial statements filed with this Department in accordance with such statement's instructions, henceforth. It is noted that a similar recommendation was made in the prior examination report, with regards to the completion of Schedule P.

#### iii. Misclassification of annual statement line items

During the course of the examination, it was determined that the Company misclassified some annual statement line items. Advance premiums were included in the uncollected premiums contrary to the requirement of NAIC Statement of Statutory Accounting Principles ("SSAP") No. 53 paragraph 13 and the NAIC annual statement instructions. The Company reported as cash in its filed 2003 annual statement certificate of deposits ("CD's") that had fixed schedule of payments and maturity dates in excess of one year from the date of their acquisition. SSAP No. 26 paragraph 2 and the NAIC annual statement instructions require that such CD's be reported as bonds. Funds that were withheld from employees were included in the 'Other expense' account instead of being reported as Amounts withheld or retained for the account of others as indicated in SSAP No. 67 paragraphs 7 and 8 and as required by the NAIC annual statement instructions. Therefore, it is recommended that the Company comply with applicable SSAP's when completing annual statements filed with this Department.

#### iv. Reconciliation of accounts

The Company's premium database produces various reports relative to premiums. During the review of the premium cycle, it was determined that the Company did not reconcile premium reports, thus premium subsidiary ledgers did not tie to the general ledger. In addition, an examination review of the amount reported as investment income due and accrued indicated that the Company significantly overstated the balance. It was noted from the review that no periodic reconciliation was done to reduce the booked annual interest income by the amount received at the end of the month or quarter, as the case may be. Therefore, it is recommended that the Company review and reconcile the general ledger to the

premium reports (subsidiary ledgers) and to the investment ledger on a monthly basis in order to identify possible discrepancies and to facilitate the verification of its financial statements as required by Section 6611(a)(1) of the New York Insurance Law.

v. Regulation 30

The examination review of the 2003 annual statement Underwriting and Investment Exhibit, Part 3, indicated that the Company has not been properly allocating expense items to expense categories in accordance with the requirements of Regulation 30. Furthermore, the time study report that the Company provided to support the allocation of salaries to the various expense groups did not reflect the allocation percentages reported in Part 3 of the 2003 filed annual statement U & I Exhibit. In a letter dated March 21, 2005, the Company acknowledged the examination findings and indicated that it had no documentation to support the percentages used in the allocation of expense items amongst the major expense groups. Therefore, it is recommended that the Company allocate expenses to each expense category in accordance with the Department Regulation 30. It is further recommended that management establish and maintain written documentation supporting the allocation of each expense category to the major expense groups as required by Department Regulation 30.

vi. Limitation of Investments

The Company maintains a number of Certificate of Deposit (“CD”) investments with various banks. As of December 31, 2003, the Company had three separate CD investments in one bank, the aggregate amount of which was in excess of ten percent of its admitted assets as of December 31, 2003. In addition, the total CD investment held in the bank was in excess of the amount guaranteed by the Federal Deposit Insurance Corporation (“FDIC”).

Section 1409(a) of the NYIL states, in part, that, “... no domestic insurer shall have more than ten percent of its admitted assets ... invested in, or loaned upon, the securities (including for this purpose certificates of deposit) ... of any one institution.” Section 6623(c) of the NYIL provides assessment cooperative insurers with an exception to Section 1409(a).

Section 6623(c) of the NYIL states, in part, that “... an assessment corporation may invest in certificates of deposit of any one institution in an amount not to exceed the amount guaranteed by the Federal Deposit Insurance Corporation.” With its aggregate CD investments with one institution exceeding the amount guaranteed by the FDIC, the Company is not in compliance with Section 1409(a) of the NYIL. Therefore, it is recommended that the Company comply with Section 1409(a) of the NYIL and

limit its investments to ten percent of admitted assets in any one institution, unless the Section 6623(c) exception is applicable.

vii. Fidelity Bond Coverage

During the review of the insurance coverage in force as of December 31, 2003, it was found that the Company did not maintain fidelity insurance. During the course of the examination, the Company sought and obtained coverage, nevertheless, it is recommended that the Company maintain fidelity insurance at all times equal to at least the minimum amount recommended in the NAIC's Financial Condition Examiners Handbook in order to adequately protect its assets.

viii. CPA Contracts

The Company's contracts with its CPA firm, that were in force for the last three years covered by the examination, were found to be not in full compliance with Part 89.2 of Regulation 118. It is recommended that going forward the Company's contract with its CPA firm comply with the requirements put forth in Department Regulation 118.

ix. General System Controls

The prior examination report contained a recommendation that the Company develop plans to continue operations in the event of the sudden departure or prolonged unexpected absence of a key employee in order to protect the best interests of the Company's policyholders. In 2001, the Company had to request an extension for the filing of its 2000 annual statement with the Department due to the medical problems of the key person. In response to the examination finding, the Company developed a Business Resumption Plan. An examination review of the plan indicated that several updates need to be made to reflect the current management and staff. Therefore, it is recommended that the Company update its Business Resumption Plan and review it on a regular basis to ensure that it adequately addresses the current situation at the Company in order to protect the best interests of the Company and its policyholders.

3. FINANCIAL STATEMENTSA Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2003 as determined by this examination and as reported by the Company:

Assets

	<u>Assets</u>	<u>Not Admitted Assets</u>	<u>Net Admitted Assets</u>
Bonds	\$283,998	\$-0-	\$283,998
Common stocks	4,589	-0-	4,589
Real estate occupied by Company	24,868	-0-	24,868
Cash, cash equivalents & short-term investments	975,499	-0-	975,499
Investment income due and accrued	43,429	-0-	43,429
Uncollected premiums and agents' balances in the course of collection	69,484	25,052	44,432
Deferred premiums, agents' balances and installments booked but deferred and not yet due	138,966		138,966
Net deferred tax asset	25,524	-0-	25,524
Furniture and equipment	<u>81,922</u>	<u>81,922</u>	<u>-0-</u>
Total	<u>\$1,648,279</u>	<u>\$106,974</u>	<u>\$1,541,305</u>

Liabilities and Surplus

Losses and loss adjustment expenses		\$104,506
Commissions payable, contingent commissions and other similar charges		63,876
Other expenses (excluding taxes, licenses and fees)		6,239
Unearned premiums		850,813
Ceded reinsurance premiums payable (net of ceding commissions)		<u>90,211</u>
Total liabilities		\$1,115,645
Required surplus	\$100,000	
Unassigned Funds (surplus)	<u>325,660</u>	
Surplus as regards policyholders		<u>425,660</u>
Total liability and surplus as regards policyholders		<u>\$1,541,305</u>

Note: The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2000 through 2003. 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 decreased \$374,740 during the four-year examination period January 1, 2000 through December 31, 2003, detailed as follows:

Underwriting Income

Premiums earned		\$1,645,146
Deductions:		
Losses and loss adjustment expenses incurred	\$1,697,219	
Other underwriting expenses incurred	<u>574,191</u>	
Total underwriting deductions		<u>2,271,410</u>
Net underwriting gain or (loss)		\$(626,264)

Investment Income

Net investment income earned	\$118,097	
Net realized capital gains (losses)	<u>(983)</u>	
Net investment gain (loss)		117,114

Other Income

Net gain or (loss) from agents' or premium balances charged off	\$16,045	
Finance and service charges not included in premiums	33,717	
Aggregate write-ins for miscellaneous income	<u>17,354</u>	
Total other income		<u>67,116</u>
Net income before federal and foreign income taxes		(\$442,034)
Federal and foreign income taxes incurred		<u>(36,985)</u>
Net Income		<u>(\$405,049)</u>

Capital and Surplus Account

Surplus as regards policyholders per report on examination as of December 31, 1999			\$800,400
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income		\$405,049	
Net unrealized capital gains or (losses)		2,483	
Change in net deferred income tax	\$1,091		
Change in nonadmitted assets	76,512		
Cumulative effect of changes in accounting principles	39,433		
Aggregate write-ins for gains and losses in surplus		84,244	
	<u>\$117,036</u>	<u>\$491,776</u>	
Net increase (decrease) in surplus			<u>(374,740)</u>
Surplus as regards policyholders per report on examination as of December 31, 2003			<u>\$425,660</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$104,506 is the same as the amount reported by the Company as of December 31, 2003.

The Department's analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Company's internal records and in its filed annual statements. Such analysis indicated that the Company's loss and loss adjustment expense reserves appear adequate as of December 31, 2003.

During the examination it was noted that some of the information provided by the Company in its 2003 annual statement Schedule P was inaccurate. The Annual Statement Schedule P should be prepared as required by the National Association of Insurance Commissioners ("NAIC") annual statement instructions, to facilitate the reasonable estimation of the reserves for losses and loss adjustment expense.

## 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. Treatment of policyholders and claimants

Except as noted below, no unfair practices were encountered.

### Third Party Payments and Regulation 64

During the review of the Company's claim files, it was found that the Company issued a check of more than \$5,000 to a claimant's representative without notifying the claimant in a third party liability claim as required by Department Regulation 64 Part 216.9. It was also discovered that the copy of Regulation 64 used as reference in claim processing was outdated. In a response to the examination finding dated December 21, 2005, the Company acknowledged its error and stated its intention to comply with the requirements put forth by the Regulation in the future. During the course of the examination, the Company obtained an updated and revised edition of the Regulation. Nevertheless, it is recommended that the Company comply with Regulation 64 Part 216.9 and mail written notices to claimants at the time payment of claims over the amount stipulated in the Regulation is made to their representative. Also, it is recommended that the Company keep abreast of revisions and updates to the New York Insurance Law and the applicable insurance regulations and circular letters.

### Policy form approval

An examination review of the policy forms used by the Company indicated that the Company did not have the Department's approval to use several of the Underwriting Rating Bureau ("URB") policy forms. In addition, the policy jacket being used by the Company had not been filed with the Department as required by Section 6609(b).

Section 6609(b) of the NYIL indicates that no policy form shall be issued for delivery by an assessment corporation unless it has been filed with and approved by the Superintendent. Therefore, it is recommended that the Company comply with Section 6609(b) of the NYIL and file all policy forms to be used, including policy jackets, with the Superintendent for approval.

#### Appointment of Agents

A comparison of the Company's agents listing and the Department's indicated that some agents who were paid commission by the Company had not been formally appointed with the Department pursuant to Section 2112(a) of the NYIL. During the course of the examination, the Company appointed the said agents, based on the examination findings. Nevertheless, it is recommended that the Company comply with Section 2112(a) and file with the Department certificates of appointment for the agents it wishes to have represent it.

#### Non-Payment of Premium and Cancellation of Policies

Article V Section 3 of the Company's by-laws requires the officers of the Company to proceed to collect all annual assessments within the period of time specified in the notice sent to the insured. During the period covered by the examination, the Company routinely cancelled policies for non-payment of premium. However in two instances discovered during a special examination conducted by the Department, the Company did not proceed to collect premiums (assessments) from an officer and an employee of the Company within the period specified, nor were their policies cancelled for non-payment of premium in accordance with the provisions of Section 3425 of the NYIL.

In addition, the officer and employee noted above both had claims paid, when their policies would not have been in force had their policies been cancelled in a manner consistent with how other policyholders who didn't pay their premiums were treated. The officer involved signed the claim checks which would appear to be a violation of her fiduciary responsibilities under Section 715(h) of the NYBCL. See Section 2(A) of this report for the recommendation regarding officers not fulfilling their fiduciary responsibility to the Company and its policyholders.

Therefore, it is recommended that the Company comply with Article V Section 3 of its by-laws regarding the collection of annual premiums. Also, it is recommended that the Company consistently apply its cancellation procedures in accordance with the provisions of Section 3425 of the NYIL.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Reinsurance</u>	
It was recommended that the Company comply with the limits stated in Section 6610 of the NYIL.	7
The Company has not complied with this recommendation. See Section 2(C) of this report.	
B. <u>Accounts and Records</u>	
i. It was recommended that the Company prepare Schedule P in accordance with the NAIC annual statement instructions and accurately fill out all parts of Schedule P in all future financial statements submitted to this Department.	9
The Company has not complied with this recommendation. See Section 2(G)(ii) of this report.	
ii. It was recommended that the Company develop plans to continue operations in the event of the sudden departure or prolonged unexpected absence of a key employee in order to protect the best interests of the Company's policyholders.	9
The Company complied with the recommendation by developing the plan, but did not maintain and update it to reflect the Company's current management and prevailing conditions. See Section 2(G)(ix) of this report.	
C. <u>Custodial Agreement</u>	
It was recommended that the Company transfer all securities, then held by a brokerage firm, into an authorized banking institution to comply with Circular Letters Nos. 1 and 2 dated March 14, 1975 and February 1, 1977, respectively.	10
The Company has complied with this recommendation.	

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
i. It is recommended that the Company comply with Section 6611(a)(3) of the NYIL and maintain formal minutes of committee meetings.	4
ii. It is recommended that the Company adhere to all provisions of its by-laws.	4
iii. It is recommended that the Company comply with Section 712(a) of the NYBCL regarding board approval of membership to committees.	4
iv. It is recommended that the Company comply with Section 6611(a)(4)(C) of the NYIL regarding signature requirements on checks.	4
v. It is recommended that, henceforth, the directors and the officers of the Company remain mindful of their fiduciary responsibilities to the Company and its policyholders, as set forth in Section 717(a) and 715(h) of the NYBCL. In addition, the Company is directed to replace any director and/or officer who cannot or does not fulfill their duties in good faith and with that degree of care, which an ordinarily prudent person in a like position would use under similar circumstances.	5
B. <u>Territory and Plan of Operation</u>	
It is recommended that the Company write only in the counties it has been licensed in pursuant to Section 6608(b) of the NYIL.	5

<u>ITEM</u>	<u>PAGE NO.</u>
C. <u>Reinsurance</u>	
i. It is recommended that the Company comply with Sections 6610(d) and (e) of the NYIL and limit its net insurance on a single casualty risk and on a single risk and occurrence of specified catastrophe perils to the limitations put forth by Section 6610 of the NYIL. It is noted that a similar recommendation was included in the prior report on examination.	8
ii. It is recommended that the Company comply with Section 6606(a)(2) of the NYIL by ceding to authorized or accredited reinsurers only, unless otherwise permitted by the superintendent.	9
D. <u>Accounts and Records</u>	
i. It is recommended that the Company comply with Section 1411(a) of the NYIL and have all investment transactions authorized or approved by the board of directors or a committee thereof responsible for supervising or making such investments.	10
ii. It is recommended that the Company complete all financial statements filed with this Department in accordance with such statement's instructions, henceforth. It is noted that a similar recommendation was included in the prior report regarding the completion of Schedule P.	11
iii. It is recommended that the Company comply with applicable SSAP's when completing annual statements filed with this Department.	11
iv. It is recommended that the Company review and reconcile the general ledger to the premium reports (subsidiary ledgers) and to the investment ledger on a monthly basis in order to identify possible discrepancies and to facilitate the verification of its financial statements as required by Section 6611(a)(1) of the New York Insurance Law.	11-12

<u>ITEM</u>	<u>PAGE</u> <u>NO.</u>
v. It is recommended that the Company allocate expenses to each expense category in accordance with the Department Regulation 30. It is further recommended that management establish and maintain written documentation supporting the allocation of each expense category to the major expense groups as required by Department Regulation 30.	12
vi. It is recommended that the Company comply with Section 1409(a) and limit its investments to ten percent of its admitted assets in any one institution, unless the Section 6623(c) exception is applicable.	12-13
vii. It is recommended that the Company maintain fidelity insurance at all times equal to at least the minimum amount recommended in the NAIC's Financial Condition Examiners Handbook in order to adequately protect its assets.	13
viii. It is recommended that going forward the Company's contract with its CPA firm comply with the requirements put forth in Department Regulation 118.	13
ix. It is recommended that the Company update its Business Resumption Plan and review it on a regular basis to ensure that it adequately addresses the current situation at the Company in order to protect the best interests of the Company and its policyholders.	13

E Market Conduct

i. It is recommended that the Company comply with Regulation 64 Part 216.9 and mail written notices to claimants at the time payment of claims over the amount stipulated in the Regulation is made to their representative. Also, it is recommended that the Company keep abreast of revisions and updates to the New York Insurance Law and the applicable insurance regulations and circular letters.	18
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<u>ITEM</u>		<u>PAGE</u> <u>NO</u>
ii.	It is recommended that the Company comply with Section 6609(b) of the NYIL and file all policy forms to be used, including policy jackets, with the Superintendent for approval.	19
iii.	It is recommended that the Company comply with Section 2112(a) and file with the Department certificates of appointment for the agents it wishes to have represent it.	19
iv.	It is recommended that the Company comply with Article V Section 3 of its by-laws regarding the collection of annual premiums. Also, it is recommended that the Company consistently apply its cancellation procedures in accordance with the provisions of Section 3425 of the NYIL.	19



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Nyantakyi Akuoko  
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.

151  
Nyantakyi Akuoko

Subscribed and sworn to before me

this 22<sup>ND</sup> day of APRIL 2005

151  
CHIANNE M. BURKE  
Notary Public, State of New York  
Qualified in Albany County  
No. 013U5076509 2007  
Commission Expires April 21, 2007

Appointment No 22247

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:

**Nyantakyi Akuoko**

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

**Otsego County Patrons Co-operative Fire Relief Association**

*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 10th day of \*August, 2004*



  
\_\_\_\_\_  
GREGORY V. SERIO  
Superintendent of Insurance