

Examination Warrant Number 18-00000-17744-R1

**Report of Examination of
Seaway Mutual Insurance Company
Erie, Pennsylvania**

As of December 31, 2018

For Informational Purposes Only

Seaway Mutual Insurance Company

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Harrisburg, Pennsylvania
November 19, 2019

Honorable Joseph DiMemmo, CPA
Deputy Insurance Commissioner
Commonwealth of Pennsylvania
Insurance Department
Harrisburg, Pennsylvania

Dear Sir:

In accordance with instructions contained in Examination Warrant Number 18-00000-17744-R1, dated August 14, 2018, an examination was made of

Seaway Mutual Insurance Company, NAIC Code: 17744

a Pennsylvania domiciled, single-state, property and casualty mutual insurance company hereinafter referred to as the "Company."

A report of this examination is hereby respectfully submitted.

SCOPE OF EXAMINATION

The Pennsylvania Insurance Department ("Department") has performed an examination of the Company, which was last examined as of December 31, 2013. This examination covered the five-year period from January 1, 2014 through December 31, 2018.

Work programs employed in the performance of this examination were designed to comply with the standards promulgated by the Department and the National Association of Insurance Commissioners ("NAIC") *Financial Condition Examiners Handbook* ("Handbook").

The Handbook requires that the Department plan and perform the examination to evaluate the financial condition, assess corporate governance, identify current and prospective risks of the Company, evaluate system controls and procedures used to mitigate those risks, and review subsequent events. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with statutory accounting principles.

The examination does not attest to the fair presentation of the financial statements included herein. Statements were prepared by management and are therefore the responsibility of management. If, during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately following the Company's financial statements.

This examination report includes significant findings of fact, in accordance with 40 P.S. § 323.5(a), and general information about the Company and its financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective

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conclusions, proprietary information, etc.), are not included within the examination report but separately communicated to other regulators and/or the Company.

For each year during the period under examination, the Company was exempt from filing an audited financial statement prepared by a certified public accountant by meeting the criteria outlined in 31 Pa. Code § 147.13(e).

HISTORY

The Company was incorporated on March 11, 1971, licensed by the Department on December 30, 1971 and commenced business on or about that same date.

The Company is currently authorized to transact those classes of insurance described in 40 P.S. § 382, (b)(1) Property and Allied Lines.

MANAGEMENT AND CONTROL

SURPLUS REQUIREMENTS

The Company's minimum surplus requirement to conduct the business described above, pursuant to 40 P.S. § 386 is \$100,000 in minimum surplus. The Company has met all governing surplus requirements throughout the examination period.

INSURANCE HOLDING COMPANY SYSTEM

The Company is not part of a holding company system.

BOARD OF DIRECTORS

Management of the Company is vested in its Board of Directors ("Board"), which was comprised of the following members as of the examination date, December 31, 2018:

| Name and Address | Principal Occupation |
|--|--|
| Christopher S. Baldwin Erie, Pennsylvania | Retired |
| Drew R. Baldwin Erie, Pennsylvania | Construction Manager Baldwin Brothers, Inc. |
| Gregory G. Baldwin Girard, Pennsylvania | Retired |
| Gregory S. Baldwin Erie, Pennsylvania | President Baldwin Brothers, Inc. |

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John R. Baldwin, II
Erie, Pennsylvania

Real Estate Investor
Self Employed

Matthew J. Baldwin
Fairview, Pennsylvania

Vice President/Real Estate Development
Baldwin Brothers, Inc.

Brian T. Ferraro
Erie, Pennsylvania

Chief Financial Officer and Controller
Baldwin Brothers, Inc.

Directors are elected at the Company's annual meeting and serve a term of three years. Terms are staggered such that the terms of no more than four directors expire in any one year.

COMMITTEES

As of the examination date, December 31, 2018, the following committee was appointed by the Board and serving in accordance with the Company's by-laws:

Executive Committee

Gregory G. Baldwin
Matthew J. Baldwin
Brian T. Ferraro

OFFICERS

As of the examination date, December 31, 2018, the following officers were appointed and serving in accordance with the Company's by-laws:

| Name | Title |
|------------------------|---------------------------------------|
| Matthew J. Baldwin | President and Chief Executive Officer |
| Brian T. Ferraro | Treasurer and Chief Financial Officer |
| Christopher S. Baldwin | Corporate Secretary |
| Gregory G. Baldwin | Vice President |

CORPORATE RECORDS

MINUTES

A compliance review of corporate minutes revealed the following:

- The Annual Meetings of the Company's policyholders were not held in compliance with its by-laws. Specifically, the Annual Meetings were held on days other than the last Tuesday of April as specified by the by-laws. Subsequent to the examination period, the Company's Board amended the by-laws to allow the Annual Meetings to occur any date in April during which a quorum of directors could be present.
- The policyholders elect directors at such meetings in compliance with its by-laws.

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- Quorums were present at all directors' meetings.
- The Company's investment transactions are approved quarterly by the Board.
- All directors attend Board meetings regularly.
- The Company's Executive Committee approves the reinsurance contracts.

ARTICLES OF AGREEMENT

The Company made no changes to its Articles of Agreement during the examination period.

BY-LAWS

The Company made no changes to its by-laws during the examination period. As discussed above, and subsequent to the examination period, the Company's Board amended the by-laws to allow the Annual Meetings to occur any date in April during which a quorum of directors could be present.

SERVICE AND OPERATING AGREEMENTS

The Company is party to a Personnel and Expense Allocation Agreement with Baldwin Brothers, Inc. effective January 1, 2015. The Company agrees to pay Baldwin Brothers, Inc. for services including, but not limited to, accounting, data processing, communication and other related office services. This Agreement replaces the prior Personnel and Expense Allocation Agreement dated January 1, 1998.

REINSURANCE

CEDED

As of December 31, 2018, the Company is a party to two reinsurance contracts through its reinsurance intermediary, Guy Carpenter & Company, LLC ("Guy Carpenter"), a Quota Share contract and an Obligatory First Surplus contract. The contracts have effective dates of January 1, 2018, with a term of one year. The Company's total ceded premium for 2018 was \$4,105 (approximately 79.2% of direct written premium). The Company's net amount recoverable for 2018 was \$0. As of December 31, 2018, the Company had \$1,726 outstanding due from its reinsurers.

The Company's reinsurance contracts are with a pool of reinsurers each assuming a certain percentage through Guy Carpenter. All reinsurers are licensed or qualified by the Commonwealth of Pennsylvania. The listing of participating reinsurers, their pool percentages and a summary of each contract is provided below:

American Agricultural Insurance Company – 18.50%
Aspen Insurance UK Limited – 2.30%

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Berkley Insurance Company – 14.00%
Employers Mutual Casualty Company – 15.25%
Farmers Mutual Hail Insurance Company of Iowa – 8.75%
Hannover Rück SE – 6.50%
Partner Reinsurance Company of the U.S. – 3.00%
Renaissance Reinsurance U.S. Inc. – 4.00%
Swiss Reinsurance America Corporation – 18.50%
The Toa Reinsurance Company of America – 9.20%

The Quota Share Reinsurance contract covers 20% of business reinsured subject to a maximum cession of \$5,000 per risk.

The Obligatory First Surplus Reinsurance contract covers an amount equal to five times the Company's retention with a minimum retention of \$25,000, and a maximum cession of \$125,000 on any one risk.

The Company's reinsurance intermediary, Guy Carpenter, is licensed by the Department as required by 40 P.S. § 321.2(a). The Company operates this program pursuant to a properly executed written authorization between the Company and Guy Carpenter as required by 40 P.S. § 321.3.

All reinsurance contracts contain appropriate insolvency and arbitration clauses. Additionally, all contracts meet the minimum risk transfer requirements outlined in the Statement of Statutory Accounting Principles No. 62R.

ASSUMED

The Company did not assume any business during the examination period.

TERRITORY AND PLAN OF OPERATION

The Company is licensed only in Pennsylvania and provides coverage exclusively for properties owned by Baldwin Brothers, Inc. and Baldwin Family entities being real estate developers and investors, operating primarily in Erie County, Pennsylvania.

| Line of Business | Direct and Assumed Premium | Ceded Premium | Net Written Premium | Percentage of Total |
|-------------------|----------------------------------|------------------|------------------------|------------------------|
| December 31, 2018 | | | | |
| Fire | \$ 5,180 | \$ 4,105 | \$ 1,075 | 100.0% |
| Totals | \$ 5,180 | \$ 4,105 | \$ 1,075 | 100.0% |

All policies are written by one agent who is also a member of the Board of Directors.

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SIGNIFICANT OPERATING RATIOS AND TRENDS

The underwriting ratios summarized below are shown on an earned/incurred basis, and encompass the five-year period covered by this examination.

| | Amount | Percentage |
|---|-----------|------------|
| Premiums earned | 50,154 | 100.0 % |
| Losses incurred | 4,207 | 8.4 % |
| Loss expenses incurred | 0 | 0.0 % |
| Other underwriting expenses incurred | 303,767 | 605.7 % |
| Aggregate write-ins for underwriting deductions | 0 | 0.0 % |
| Net income of protected cells | 0 | 0.0 % |
| Net underwriting gain or (loss) | (257,820) | (514.1)% |
| Totals | 50,154 | 100.0 % |

The Company reported the following net underwriting, investment, and other gains or losses during the period under examination:

| | 2018 | 2017 | 2016 | 2015 | 2014 |
|----------------------------------|--------------|--------------|--------------|--------------|--------------|
| Admitted assets | \$ 1,992,152 | \$ 2,040,929 | \$ 2,076,094 | \$ 2,073,689 | \$ 2,064,779 |
| Liabilities | \$ 30,087 | \$ 29,410 | \$ 23,874 | \$ 19,828 | \$ 15,152 |
| Surplus as regards policyholders | \$ 1,962,065 | \$ 2,011,519 | \$ 2,052,220 | \$ 2,053,861 | \$ 2,049,627 |
| Gross premium written | \$ 5,180 | \$ 51,135 | \$ 48,090 | \$ 62,517 | \$ 72,402 |
| Net premium written | \$ 1,075 | \$ 8,485 | \$ 7,540 | \$ 11,625 | \$ 13,298 |
| Underwriting gain/(loss) | \$ (64,271) | \$ (63,757) | \$ (45,929) | \$ (42,124) | \$ (41,739) |
| Investment gain/(loss) | \$ 36,173 | \$ 32,800 | \$ 30,671 | \$ 37,347 | \$ 49,139 |
| Other gain/(loss) | \$ 0 | \$ 0 | \$ 0 | \$ 0 | \$ 0 |
| Net income | \$ (28,098) | \$ (30,957) | \$ (15,258) | \$ (4,777) | \$ 7,400 |

PENDING LITIGATION

As of the date of this examination report, November 19, 2019, the Company was not involved in any litigation and was not aware of any threatened litigation that could have a material adverse effect on its financial condition.

FINANCIAL STATEMENTS

The financial condition of the Company, as of December 31, 2018, and the results of its operations for the five-year period under examination, are reflected in the following statements*:

- Comparative Statement of Assets, Liabilities, Surplus and Other Funds;
- Comparative Statement of Income;
- Comparative Statement of Capital and Surplus; and
- Comparative Statement of Cash Flow

*Note: Some financials shown in this report may contain immaterial differences to those reported in the Company's filed Annual Statements due to rounding errors.

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**Comparative Statement of Assets, Liabilities, Surplus and Other Funds
As of December 31,**

| | 2018 | 2017 | 2016 | 2015 | 2014 |
|--|---------------------|---------------------|---------------------|---------------------|---------------------|
| Bonds | \$ 1,367,503 | \$ 1,517,434 | \$ 1,460,780 | \$ 1,577,613 | \$ 1,521,079 |
| Cash, cash equivalents, and short term investments | 622,923 | 523,495 | 604,453 | 471,952 | 534,812 |
| Subtotals, cash and invested assets | 1,990,426 | 2,040,929 | 2,065,233 | 2,049,565 | 2,055,891 |
| Other amounts receivable under reinsurance contracts | 1,726 | 0 | 10,861 | 24,124 | 8,888 |
| Total | \$ 1,992,152 | \$ 2,040,929 | \$ 2,076,094 | \$ 2,073,689 | \$ 2,064,779 |
| Other expenses | \$ 30,000 | \$ 24,000 | \$ 18,000 | \$ 12,000 | \$ 6,000 |
| Taxes, licenses and fees | (817) | 27 | (70) | (53) | 117 |
| Unearned premiums | 904 | 5,383 | 5,944 | 7,881 | 9,035 |
| Total liabilities | 30,087 | 29,410 | 23,874 | 19,828 | 15,152 |
| Unassigned funds (surplus) | 1,962,065 | 2,011,519 | 2,052,220 | 2,063,861 | 2,049,627 |
| Surplus as regards policyholders | 1,962,065 | 2,011,519 | 2,052,220 | 2,063,861 | 2,049,627 |
| Totals | \$ 1,992,152 | \$ 2,040,929 | \$ 2,076,094 | \$ 2,073,689 | \$ 2,064,779 |

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Comparative Statement of Income For the Year Ended December 31,

| | 2018 | | 2017 | | 2016 | | 2015 | | 2014 | |
|---|------|----------|------|----------|------|----------|------|----------|------|----------|
| | \$ | | \$ | | \$ | | \$ | | \$ | |
| Underwriting Income | | | | | | | | | | |
| Premiums earned | \$ | 5,554 | \$ | 9,046 | \$ | 9,477 | \$ | 12,779 | \$ | 13,298 |
| Deductions: | | | | | | | | | | |
| Losses incurred | | 0 | | 4,203 | | 0 | | 0 | | 4 |
| Other underwriting expenses incurred | | 69,825 | | 68,600 | | 55,406 | | 54,903 | | 55,033 |
| Total underwriting deductions | | 69,825 | | 72,803 | | 55,406 | | 54,903 | | 55,037 |
| Net underwriting gain or (loss) | | (64,271) | | (63,757) | | (45,929) | | (42,124) | | (41,739) |
| Investment Income | | | | | | | | | | |
| Net investment income earned | | 36,769 | | 33,343 | | 33,521 | | 37,249 | | 46,659 |
| Net realized capital gains or (losses) | | (596) | | (543) | | (2,850) | | 98 | | 2,480 |
| Net investment gain or (loss) | | 36,173 | | 32,800 | | 30,671 | | 37,347 | | 49,139 |
| Net income before dividends to policyholders and before federal and foreign income taxes | | (28,098) | | (30,957) | | (15,258) | | (4,777) | | 7,400 |
| Net income | \$ | (28,098) | \$ | (30,957) | \$ | (15,258) | \$ | (4,777) | \$ | 7,400 |

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**Comparative Statement of Capital and Surplus
For the Year Ended December 31,**

| | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|--------------|--------------|--------------|--------------|--------------|
| Surplus as regards policyholders, December 31, previous year | \$ 2,011,519 | \$ 2,052,220 | \$ 2,053,861 | \$ 2,049,627 | \$ 1,820,865 |
| Net income | (28,098) | (30,957) | (15,258) | (4,777) | 7,400 |
| Net unrealized capital gains or (losses) | (24,221) | (12,474) | 11,017 | 6,534 | (3,895) |
| Change in nonadmitted assets | 2,865 | 2,730 | 2,600 | 2,477 | 225,257 |
| Change in surplus as regards policyholder for the year | (49,454) | (40,701) | (1,641) | 4,234 | 228,762 |
| Surplus as regards policyholders, December 31, current year | \$ 1,962,065 | \$ 2,011,519 | \$ 2,052,220 | \$ 2,053,861 | \$ 2,049,627 |

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Comparative Statement of Cash Flow For the Year Ended December 31,

| | 2018 | 2017 | 2016 | 2015 | 2014 |
|---|------------|------------|------------|------------|------------|
| Cash from Operations | | | | | |
| Premiums collected net of reinsurance | \$ 1,075 | \$ 8,485 | \$ 7,540 | \$ 11,625 | \$ 12,400 |
| Net investment income | 36,769 | 33,343 | 33,521 | 37,249 | 46,659 |
| Total income | 37,844 | 41,828 | 41,061 | 48,874 | 59,059 |
| Benefit and loss related payments | 0 | 0 | 0 | 0 | 5,295 |
| Commissions, expenses paid and aggregate write-ins for deductions | 69,825 | 68,600 | 55,406 | 54,903 | 55,033 |
| Total deductions | 69,825 | 68,600 | 55,406 | 54,903 | 60,328 |
| Net cash from operations | (31,981) | (26,772) | (14,345) | (6,029) | (1,269) |
| Cash from Investments | | | | | |
| Proceeds from investments sold, matured or repaid: | | | | | |
| Bonds | 250,596 | 100,543 | 627,850 | 90,087 | 200,061 |
| Mortgage loans | 2,865 | 2,730 | 2,600 | 2,477 | 225,257 |
| Miscellaneous proceeds | 1,192 | 0 | 0 | 98 | 0 |
| Total investment proceeds | 254,653 | 103,273 | 630,450 | 92,662 | 425,318 |
| Cost of investments acquired (long-term only): | | | | | |
| Bonds | 125,000 | 170,000 | 500,000 | 140,087 | 203,220 |
| Miscellaneous applications | 596 | 543 | 2,850 | 0 | 0 |
| Total investments acquired | 125,596 | 170,543 | 502,850 | 140,087 | 203,220 |
| Net cash from investments | 129,057 | (67,270) | 127,600 | (47,425) | 222,098 |
| Cash from Financing and Miscellaneous Services | | | | | |
| Other cash provided (applied): | | | | | |
| Other cash provided or (applied) | 2,352 | 13,084 | 19,246 | (9,406) | (3,026) |
| Net cash from financing and miscellaneous sources | 2,352 | 13,084 | 19,246 | (9,406) | (3,026) |
| Reconciliation of cash and short-term investments: | | | | | |
| Net change in cash and short-term investments | 99,428 | (80,958) | 132,501 | (62,860) | 217,803 |
| Cash and short-term investments: | | | | | |
| Beginning of the year | 523,495 | 604,453 | 471,952 | 534,812 | 317,009 |
| End of the year | \$ 622,923 | \$ 523,495 | \$ 604,453 | \$ 471,952 | \$ 534,812 |

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SUMMARY OF EXAMINATION CHANGES

There were no examination changes to the preceding financial statements as filed with regulatory authorities over the review period.

NOTES TO FINANCIAL STATEMENTS

ASSETS

INVESTMENTS

As of December 31, 2018, the Company's invested assets were distributed as follows:

| | Amount | Percentage |
|------------------------|------------------|----------------|
| Bonds | 1,367,503 | 68.7 % |
| Cash | 325,194 | 16.3 % |
| Short-term investments | 297,729 | 15.0 % |
| Totals | <u>1,990,426</u> | <u>100.0 %</u> |

The Company's bond and short-term investment portfolio had the following quality and maturity profiles:

| NAIC Designation | Amount | Percentage |
|---------------------|------------------|----------------|
| 1 - highest quality | 1,665,232 | 100.0 % |
| Totals | <u>1,665,232</u> | <u>100.0 %</u> |

| Years to Maturity | Amount | Percentage |
|-------------------|------------------|----------------|
| 1 year or less | 762,648 | 45.8 % |
| 2 to 5 years | 646,927 | 38.8 % |
| 6 to 10 years | 255,657 | 15.4 % |
| Totals | <u>1,665,232</u> | <u>100.0 %</u> |

The Company invests conservatively, primarily in certificates of deposits and treasury notes, which are highly liquid assets. The Company maintains a custodial agreement to safeguard its assets; however, this custodial agreement was not in compliance with 31 Pa. Code § 148a.3 during the examination period. Subsequent to the date of this examination report, on December 15, 2019, the Company executed a custodial agreement with Comerica Bank & Trust, N.A. which is now in compliance with 31 Pa. Code § 148a.3.

The Company has a written investment policy as required by 40 P.S. § 653b(b); however, during the examination period, it was not reviewed and approved on an annual basis by the Board of Directors.

It is recommended that the investment policy be reviewed and approved annually by the Board of Directors in compliance with 40 P.S. § 653b(b).

The Company was following its investment policy at December 31, 2018.

LIABILITIES

LOSS AND LOSS ADJUSTMENT EXPENSE RESERVES

The Company reported net reserves in the amount of \$0 for losses and \$0 for loss adjustment expenses ("LAE") on its December 31, 2018 Annual Statement.

For each year during the examination period, the Company was exempt from the requirement to file a Statement of Actuarial Opinion on the adequacy of its loss reserves as provided in the NAIC *Annual Statement Instructions – Property and Casualty*. This exemption was granted annually to the Company in correspondence received from the Department.

Based on the procedures performed and the results obtained, the examination team obtained sufficient documentation to support the conclusion that the Company's carried loss and LAE reserve amounts are reasonably stated as of December 31, 2018.

SUBSEQUENT EVENTS

There were no significant subsequent events noted during the course of this examination and up to the date of this examination report that would have a material financial impact on the Company.

RECOMMENDATIONS

PRIOR EXAMINATION

The prior examination report contained no recommendations.

CURRENT EXAMINATION

As a result of the current examination, the following recommendation is being made:

- 1. It is recommended that the investment policy be reviewed and approved annually by the Board of Directors in compliance with 40 P.S. § 653b(b) (see "Investments", page 11).*

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CONCLUSION

As a result of this examination, the financial condition of Seaway Mutual Insurance Company, as of December 31, 2018, was determined to be as follows:

| | Amount | Percentage |
|----------------------------------|------------------|----------------|
| Admitted assets | <u>1,992,152</u> | <u>100.0 %</u> |
| Liabilities | 30,087 | 1.5 % |
| Surplus as regards policyholders | <u>1,962,065</u> | <u>98.5 %</u> |
| Total liabilities and surplus | <u>1,992,152</u> | <u>100.0 %</u> |

Since the previous examination, made as of December 31, 2013, the Company's assets increased by \$155,929, its liabilities increased by \$14,729, and its surplus increased by \$141,200.

This examination was conducted by Elizabeth McGarry, AFE.

Respectfully,

Melissa L. Greiner

Melissa L. Greiner
Director
Bureau of Financial Examinations

Shannon Hopkins - LT

Shannon Hopkins, CFE
Examination Manager

Elizabeth McGarry - LT

Elizabeth McGarry, AFE
Examiner-in-Charge

The CFE designation has been conferred by an organization not affiliated with the federal or any state government. However the CFE designation is the only designation recognized by the NAIC for the purposes of directing statutory Association examinations of insurance companies.