

REPORT ON EXAMINATION

OF THE

NAVIGATORS INSURANCE COMPANY

AS OF

DECEMBER 31, 2004

DATE OF REPORT

JULY 7, 2006

EXAMINER

JAMES MURPHY

## TABLE OF CONTENTS

<u>ITEM NO.</u>		<u>PAGE NO.</u>
1	Scope of examination	2
2.	Description of Company	3
	A. Management	3
	B. Territory and plan of operation	5
	C. Reinsurance	7
	D. Holding company system	12
	E. Abandoned Property Law	15
	F. Significant operating ratios	15
	G. Accounts and records	16
3.	Financial statements	16
	A. Balance sheet	16
	B. Underwriting and investment exhibit	18
4.	Losses and loss adjustment expenses	19
5.	Market conduct activities	19
6.	Compliance with prior report on examination	20
7.	Summary of comments and recommendations	22



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

January 7, 2007

Mr. Louis W. Pietroluongo  
Acting 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 22424 dated October 13, 2005 attached hereto, I have made an examination into the condition and affairs of Navigators Insurance Company as of December 31, 2004, and submit the following report thereon.

Wherever the designations “the Company” or “Navigators” appear herein without qualification, they should be understood to indicate Navigators Insurance Company.

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 administrative offices located at 6 International Drive, Rye Brook, New York 10573.

## 1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 2000. This examination covered the four-year period from January 1, 2001 through December 31, 2004. 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, 2004. 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 ("NAIC"):

- 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

The Company was incorporated under the laws of the State of New York on July 16, 1981. Active underwriting operations began on April 1, 1983.

Capital paid-in is \$5,000,000, consisting of 100 shares of common stock at \$50,000 par value per share and gross paid-in and contributed surplus is \$141,122,108. All of the outstanding capital stock of the Company is owned by the Navigators Group, Inc., a publicly traded company, which is in turn 30% owned by Terence N. Deeks and family.

Gross paid in and contributed surplus increased by \$95,000,000 during the examination period, as follows:

<u>Year</u>	<u>Description</u>	<u>Amount</u>
2001	Beginning gross paid in and contributed surplus	\$46,122,108
2003	Surplus contribution	\$95,000,000
	Total Surplus Contributions	<u>95,000,000</u>
2004	Ending gross paid in and contributed surplus	<u>\$141,122,108</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 nor more than twenty-one members. The board meets four times during each calendar year. At December 31, 2004, the board of directors was comprised of the following sixteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Michael L. Civisca West Nyack, NY	President, Marine Division, Navigators Insurance Company
Terence N. Deeks Summit, NJ	Chairman, Navigators Insurance Company
Christopher C. Duca Rockville Centre, NY	President, Navigators Pro
Richard S. Eisdorfer Trumbull, CT	Senior Vice President and Chief Information Officer, Navigators Insurance Company

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Stanley A. Galanski Ridgefield, CT	President, Navigators Insurance Company
Noel Higgit Menlo Park, CA	President, Navigators California Insurance Services
David E. Hope Ansty Sussex, Great Britian	Director, Navigators Management UK, Ltd.
Christopher A. Johnson Oakland, CA	Executive Vice President, Navigators California Insurance Services
Russell J. Johnson Seaford, NY	Senior Vice President, Navigators Management Company
John W. Jones Kingwood, TX	President, Navigators Insurance Services of Texas
Jane E. Keller Southport, CT	Senior Vice President and Chief Claims Officer, Navigators Insurance Company
Paul J. Malvasio Westport, CT	Executive Vice President and Chief Financial Officer, Navigators Insurance Company
Salvatore A. Margarella Staten Island, NY	Vice President and Treasurer, Navigators Insurance Company
Gregory D. Olson Seattle, WA	President, Navigators Insurance Services of Washington
Richard C. Rea Ockley, Surrey, Great Britian	Vice President and Managing Director, Navigators Management UK, Ltd.
Bradley D. Wiley Ringwood, NJ	Senior Vice President and Secretary, Navigators Insurance Company

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.

As of December 31, 2004, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Stanley A. Galanski	President
Paul J. Malvasio	Executive Vice President and CFO
Bradley D. Wiley	Senior Vice President and Secretary
Salvatore A. Margarella	Vice President and Treasurer

B. Territory and Plan of Operation

As of December 31, 2004, the Company was licensed to write business in all fifty states, the District of Columbia, the US Virgin Islands and Venezuela. In addition, the Company is licensed in the United Kingdom where the Company operates a branch.

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>
3	Accident & health
4	Fire
5	Miscellaneous property damage
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
10	Elevator
11	Animal
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
16	Fidelity and surety
17	Credit
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity

The Company is empowered to transact such workers' compensation insurance as may be incident to coverages contemplated under paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law, including insurances described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69 Congress as amended; 33 USC Section 901 et seq. as amended) and the kinds of insurance and reinsurance as defined in paragraph (c) of Section 4102 of the New York Insurance Law.

The Company is also licensed to write Special Risk Insurance pursuant to Article 63 of the New York Insurance Law.

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 \$35,000,000. Surplus to policyholders as of December 31, 2004 was \$235,561,311. The following schedule shows the direct premiums written by the Company both in total and in New York for the period under examination:

<u>Calendar Year</u>	<u>New York State</u>	<u>Total Direct</u>	<u>Premiums Written in New York State as a % of Total Premiums</u>
2001	\$ 647,055	\$132,801,208	0.49%
2002	\$5,929,055	\$207,513,748	2.86%
2003	\$9,017,302	\$216,103,983	4.17%
2004	\$6,986,141	\$240,591,164	2.90%

The Navigators Agencies produces business for the Company and its subsidiary, NIC Insurance Company ("NIC"). They specialize in writing marine and related lines of business, specialty liability insurance and professional liability coverages.

Each of the agencies underwrites marine and related lines of business for the Company and three unaffiliated insurers comprising the Navigators Agencies Marine Pool formerly known as the Somerset Agencies Marine Pool. In 2004, the pooled business was allocated as follows:

Navigators Insurance Company	80%
Folksamerica Reinsurance Company	10%
Employers Mutual Casualty Company	5%
National Liability & Fire Insurance Company	5%

In 2005 and 2006, the Company's pool participation will increase to 85% and 100%, respectively.

C. Reinsurance

Assumed Reinsurance

Effective January 1, 1999, the Company assumes 100% of the business written by NIC Insurance Company (“NIC”) pursuant to an inter-company reinsurance agreement.

Assumed reinsurance accounted for 47% of the Company’s gross premium writings in calendar year 2004. As noted, the Company assumes business primarily from two sources: (1) an inter-company reinsurance agreement with its subsidiary, NIC (2) participation in the Navigators Agencies Marine Pool.

Ceded Reinsurance

The Company had the following ceded reinsurance program in effect at December 31, 2004:

Type of Contract

Limits and Retention

Ocean Marine Proportional Program

Bluewater Hull Coverage

67.92% authorized  
32.08% unauthorized

25.5% quota share on all policies  
subject to a maximum limit of \$6,000,000  
any one risk.

Cargo Coverage

61.20% authorized  
38.80% unauthorized

82.5% quota share on all policies,  
subject to a maximum limit of \$4,000,000  
any one risk.

Craft Coverage

57.78% authorized  
42.22% unauthorized

90% quota share on all policies,  
subject to a maximum limit of \$4,000,000  
any one risk.

Transport Coverage

33.33% authorized  
66.67% unauthorized

75% quota share on all policies,  
subject to a maximum limit of \$4,000,000  
any one risk.

Fishing Vessels Coverage

100% authorized

90% quota share on all policies,  
subject to a maximum limit of \$800,000  
any one risk.

Type of ContractFixed Premium P & I Coverage

100% unauthorized

Marine War Coverage

100% authorized

Primary Marine Liability

100% authorized

Primary Offshore Energy

65.71% authorized

34.29% unauthorized

Ocean Marine Excess of Loss CoverageWhole Account Coverage

77% authorized

23% unauthorized

Whole Account Coverage

77% authorized

23% unauthorized

Whole Account Coverage

77% authorized

23% unauthorized

Whole Account Coverage

77% authorized

23% unauthorized

Limits and Retention

50% quota share on all policies,  
subject to a maximum limit of \$20,000,000  
any one risk.

100% quota share on all policies,  
subject to a maximum limit of \$35,000,000  
any one risk.

90% quota share on first \$3,000,000  
of primary liability any one risk.

35% quota share on all policies  
subject to a maximum limit of \$8,000,000  
any one risk.

\$3,200,000 excess of loss \$4,800,000  
ultimate net loss, each and every  
risk and/or occurrence or series of losses or  
occurrences arising from one event.

\$6,000,000 excess of loss \$8,000,000  
ultimate net loss, each and every  
risk and/or occurrence or series of losses or  
occurrences arising from one event.

\$6,000,000 excess of loss \$14,000,000  
ultimate net loss, each and every  
risk and/or occurrence or series of losses or  
occurrences arising from one event.

\$12,000,000 excess of loss \$20,000,000  
ultimate net loss, each and every  
risk and/or occurrence or series of losses or  
occurrences arising from one event.

Type of ContractLimits and RetentionWhole Account Backup

100% authorized

\$24,000,000 maximum indemnity  
ultimate net loss, each and every  
risk and/or occurrence or series of losses or  
occurrences arising from one event.

Whole Account Coverage

72% authorized

28% unauthorized

\$16,000,000 excess of loss \$32,000,000  
ultimate net loss, each and every  
risk and/or occurrence or series of losses or  
occurrences arising from one event.

Whole Account Coverage

60% authorized

40% unauthorized

\$16,000,000 excess of loss \$32,000,000  
ultimate net loss, each and every  
risk and/or occurrence or series of losses or  
occurrences arising from one event.

Whole Account Coverage

49.5% authorized

50.5% unauthorized

\$24,000,000 excess of loss \$32,000,000  
ultimate net loss, each and every  
risk and/or occurrence or series of losses or  
occurrences arising from one event.

Whole Account Coverage

100% authorized

\$1,200,000 excess of loss \$800,000  
ultimate net loss, each and every  
risk and/or occurrence or series of losses or  
occurrences arising from one event.

Whole Account Backup

100% authorized

\$1,200,000 excess of loss \$800,000  
ultimate net loss, each and every  
risk and/or occurrence or series of losses or  
occurrences arising from one event.

Whole Account Backup

77% authorized

23% unauthorized

\$2,000,000 excess of loss \$2,000,000  
ultimate net loss, each and every  
risk and/or occurrence or series of losses or  
occurrences arising from one event.

Whole Account Backup

58% authorized

42% unauthorized

\$2,800,000 excess of loss \$2,000,000  
ultimate net loss, each and every  
risk and/or occurrence or series of losses or  
occurrences arising from one event.

<u>Type of Contract</u>	<u>Limits and Retention</u>
<u>Commercial Primary Lines Multi-Line</u> 100% authorized	\$500,000 excess of loss \$500,000.
<u>Commercial Umbrella Excess</u> 100% authorized	90% quota share of \$5,000,000.
<u>Commercial Umbrella and Excess Lines</u> 63% authorized 37% unauthorized	70% of limits to \$5,000,000 80% of limits \$5,000,000 to \$10,000,000.
<u>Personal Lines</u>	
<u>Umbrella – Traditional Distribution</u> 100% authorized	75% quota share of \$1,000,000.
<u>Umbrella – Traditional Distribution</u> 100% authorized	\$4,000,000 excess of loss \$1,000,000 per occurrence.
<u>Umbrella – Internet Distribution</u> 93.33% authorized 6.67% unauthorized	75% quota share of \$5,000,000.
<u>D &amp; O and Professional Lines</u> 67% authorized 33% unauthorized	50% quota share of limits up to \$5,000,000 and 75% of limits \$5,000,000 to \$10,000,000.
<u>Architects and Engineers Professional Liability</u> 100% authorized	70% quota share of \$5,000,000.

Reinsurance agreements with affiliates were reviewed for compliance with Article 15 of the New York Insurance Law. It was noted that all affiliated reinsurance agreements were filed with the Department pursuant to the provisions of Section 1505(d) (2) of the New York Insurance Law.

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

Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in Statements of Statutory Accounting Principles (“SSAP”) No. 62 of the NAIC Accounting, Practices and Procedures Manual. Additionally, examination review indicated that the Company was not a party to any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in SSAP No. 62.

### Letters of Credit

The Navigators Agencies Marine Pool formerly known as the Somerset Agencies Marine Pool maintains letters of credit, which fund reinsurance recoverable balances due from unauthorized reinsurers to the pool members, including Navigators. Upon review of the letters of credit, it was noted that many of them include multiple applicants and beneficiaries, or indicate the beneficiary to be “Somerset Marine Incorporated (“Somerset Marine”) on behalf of Navigators Insurance Company”. For letters of credit with multiple beneficiaries, in the majority of instances, the amount of credit is allocated based on the percentage of the Company’s pool participation. For the remainder of the letters of credit, the amount of credit is allocated based on the actual amount due to each beneficiary.

The inclusion of more than one entity as beneficiary or indicating the beneficiary as “Somerset Marine Incorporated on behalf of Navigators Insurance Company” is in violation of Parts 79.1(b) and 79.1(c) of Department Regulation 133, which define “beneficiary” and “clean and unconditional”, respectively, as follows:

“(b) Beneficiary means the insurer in favor of which the letter of credit or its confirmation is established and shall include any successor by operation of law of any named beneficiary including, without limitation, any liquidator, rehabilitator, receiver or conservator.”

“(c) Clean and unconditional letter of credit or clean and unconditional confirmation means a letter of credit or confirmation which:

(1) makes no reference to any other agreement, document or entity; and

(2) provides that a beneficiary need only draw a sight draft under the letter of credit or confirmation and present it to promptly obtain funds and that no other document need be presented”.

The prior report on examination noted these violations and contained a recommendation that all letters of credit obtained by the Company comply with the provisions of Department Regulation 133.

The total amount of non-complying letters of credit as of the prior examination date of December 31, 2000 was \$55,812,484 and as of the current examination date of December 31, 2004 was \$27,377,591.

This examination has determined that all letters of credit issued after the prior report on examination were in compliance with Department Regulation 133 and the Company has made a good faith effort to correct its existing letters of credit. In addition, as noted in Section 2B of this report the Company will be a 100% participant in the marine pool beginning in 2006.

It is again recommended that the Company continue its efforts to amend all of its outstanding letters of credit to indicate the sole beneficiary as “Navigators Insurance Company” pursuant to the provisions of Department Regulation 133.

D. Holding Company System

The Company is a wholly-owned subsidiary of the Navigators Group, Inc., a publicly traded holding company domiciled in the State of Delaware, which is 30% owned by Terence N. Deeks and family. Mr. Deeks has been deemed to be the ultimate controlling person, as set forth in Section 1501 of the New York Insurance Law. The following is a chart of the holding company system as reported by the Company at December 31, 2004:



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

At December 31, 2004, the Company was party to the following agreements with other members of its holding company system:

Tax Allocation Agreement

The Company participates in a tax allocation agreement with its parent company and members of its holding company group. A formal agreement was executed and submitted to the Department pursuant to the provisions of Department Circular Letter No. 33 (1979). The agreement was effective December 31, 1983 and was amended numerous times to add various participants and to amend various terms and conditions.

Inter-Company Reinsurance Agreement

As noted in Section 2C of this report, the Company participates in an inter-company reinsurance agreement whereby the Company assumes 100% of the premiums written by its subsidiary, NIC Insurance Company. The agreement was effective January 1, 1999 and was approved by the Department pursuant to the provisions of Section 1505 of the New York Insurance Law.

Agency Agreement

The Company participates in an agency agreement with Navigators Management Company (“NMC”). Pursuant to the terms of the agreement NMC underwrites and services various lines of business on behalf of the Company. The agreement was effective January 1, 2002 and was approved by the Department pursuant to the provisions of Section 1505 of the New York Insurance Law.

Agency Agreement

The Company participates in an agency agreement with Navigators California Insurance Services (“NCIS”). Pursuant to the terms of the agreement NCIS underwrites and services business on behalf of the Company. NCIS specializes in construction liability insurance. The agreement was effective January 1, 2002 and was approved by the Department pursuant to the provisions of Section 1505 of the New York Insurance Law.

E. Abandoned Property Law

Section 1316 of the New York 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's abandoned property reports for the period of this examination were all filed on a timely basis pursuant to the provisions of Section 1316 of the New York Abandoned Property Law.

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 2004, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	.9 to 1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	86%
Premiums in course of collection to surplus as regards policyholders	29%

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 four-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$460,381,868	69.81%
Other underwriting expenses incurred	195,959,652	29.72
Net underwriting loss	<u>3,108,118</u>	<u>.47</u>
Premiums earned	<u>\$659,449,638</u>	<u>100.00%</u>

### 3. FINANCIAL STATEMENTS

#### A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2004 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$530,758,095	\$0	\$530,758,095
Common stocks	72,200,109	0	72,200,109
Cash, cash equivalents and short-term investments	62,229,162	0	62,229,162
Investment income due and accrued	5,995,182	0	5,995,182
Uncollected premiums and agents' balances in the course of collection	73,701,938	5,455,351	68,246,587
Deferred premiums, agents' balances and installments booked but deferred and not yet due	38,696,807	0	38,696,807
Amounts recoverable from reinsurers	18,132,433	0	18,132,433
Net deferred tax asset	23,409,254	14,931,901	8,477,353
Aggregate write-ins for other than invested assets	<u>520,169</u>	<u>335,169</u>	<u>185,000</u>
Total assets	<u>\$825,643,149</u>	<u>\$20,722,421</u>	<u>\$804,920,727</u>

Liabilities, surplus and other fundsLiabilities

Losses	\$327,271,259
Loss adjustment expenses	32,817,862
Commissions payable, contingent commissions and other similar charges	4,603,057
Other expenses (excluding taxes, licenses and fees)	1,238,278
Taxes, licenses and fees (excluding federal and foreign income taxes)	1,234,471
Current federal and foreign income taxes	5,970,476
Unearned premiums	87,956,178
Ceded reinsurance premiums payable (net of ceding commissions)	66,379,683
Funds held by company under reinsurance treaties	15,933,525
Amounts withheld or retained by company for account of others	1,690,556
Provision for reinsurance	16,589,901
Payable to parent, subsidiaries and affiliates	4,535,630
Payable for securities	2,796,754
Aggregate write-ins for liabilities	<u>341,788</u>
Total liabilities	\$569,359,417

Surplus and Other Funds

Common capital stock	\$ 5,000,000
Gross paid in and contributed surplus	141,122,108
Unassigned funds (surplus)	<u>89,439,203</u>
Surplus as regards policyholders	<u>235,561,311</u>
Totals	<u>\$804,920,727</u>

NOTE: The Internal Revenue Service has completed its audits of the Company's consolidated federal income tax returns through tax year 1994. All material adjustments, if any, made subsequent to the date of examination and arising from said audits, are reflected in the financial statements included in this report. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 1995 through 2004. 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 \$120,919,771 during the four-year examination period January 1, 2001 through December 31, 2004, detailed as follows:

Statement of Income

Underwriting Income

Premiums earned		\$659,449,638
Deductions:		
Losses incurred	\$389,184,893	
Loss adjustment expenses incurred	71,196,975	
Other underwriting expenses incurred	<u>195,959,652</u>	
Total underwriting deductions		<u>656,341,520</u>
Net underwriting gain or (loss)		\$3,108,118

Investment Income

Net investment income earned	\$66,837,884	
Net realized capital gain	<u>4,545,780</u>	
Net investment gain or (loss)		<u>71,383,664</u>

Other Income

Aggregate write-ins for miscellaneous income	<u>2,586,296</u>	
Total other income		<u>2,586,296</u>
Net income after dividends to policyholders and before federal and foreign income taxes		\$77,078,078
Federal and foreign income taxes incurred		<u>32,492,016</u>
Net Income		<u>\$44,586,062</u>

### C. Capital and Surplus Accounts

Surplus as regards policyholders per report on examination as of December 31, 2001			\$114,641,539
	<u>Gains in</u>	<u>Losses in</u>	
	<u>Surplus</u>	<u>Surplus</u>	
Net income	\$44,586,060		
Net unrealized capital gains or (losses)	5,063,773		
Change in net unrealized foreign exchange capital gain (loss)	929,320		
Change in net deferred income tax	8,386,763		
Change in non-admitted assets		\$16,557,735	
Change in provision for reinsurance		2,010,901	
Cumulative effect of changes in accounting principles	15,022,491		
Capital changes paid in	95,000,000		
Dividends to stockholders	<u>0</u>	<u>29,500,000</u>	
Total gains and losses	<u>\$168,988,407</u>	<u>\$48,068,636</u>	
Net increase (decrease) in surplus			<u>120,919,771</u>
Surplus as regards policyholders per report on examination as of December 31, 2004			<u>\$235,561,311</u>

#### 4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$360,089,121 is the same as the amount reported by the Company as of December 31, 2004. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Companies internal records and in its filed annual statements.

#### 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

No problem areas were encountered.

## 6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Territory and Plan of Operation</u>	
It is recommended that the Company comply with the NAIC instructions to the annual statement and list in Schedule T each alien jurisdiction.	6
The Company has complied with this recommendation.	
B. <u>Reinsurance</u>	
As it was in the prior exam, it is recommended that formal reinsurance agreements be entered into between the Company and all other pool participants that conform to the requirements of Section 1308 of the New York Insurance Law and standard insurance industry practices.	9
The Company has complied with this recommendation.	
C. <u>Holding Company System</u>	
i. It is recommended that the Company file all of the required parts of its annual holding company registration statements in a timely manner pursuant to the provisions of Part 80-1.4 of Department Regulation 52.	15
The Company has complied with this recommendation.	
ii. It is recommended that the Company amend its underwriting management agreement and incorporate the missing required provision as specified in Department Regulation 52-A.	16
The Company has complied with this recommendation.	

<u>ITEM</u>	<u>PAGE NO.</u>
iii. It is recommended that the Company comply with the provisions of Section 1505(d)(3) of the New York Insurance Law and file its underwriting agreement with affiliates on a timely basis.  The Company has complied with this recommendation.	17
iv. It is recommended that the Company submit all amendments to its inter-company agreements to this Department for our non-disapproval in a timely manner pursuant to the provisions of Section 1505(d) of the New York Insurance Law.  The Company has complied with this recommendation.	18
v. It is recommended that adequate personnel be retained and properly trained to ensure that controls are in place to protect the integrity of the data and the reliability of the systems.  The Company has complied with this recommendation.	18
D. <u>Accounts and Records</u>  It is recommended that, for future annual statement presentation, the Company appropriately report its affiliated operating advances and agents' balances accounts.  The Company has complied with this recommendation.	19
E. <u>Provision for Reinsurance</u>	
i. It is recommended that the Company continue its efforts to amend all of its outstanding letters of credit to indicate the sole beneficiary as "Navigators Insurance Company" pursuant to the provisions of Department Regulation 133.  The Company has partially complied with this recommendation. A similar comment is contained in this report.	26
ii. It is recommended that the Company formally submit its proposed solution regarding the Superintendent's ability as liquidator or rehabilitation to draw down on the letters of credit in the event of the insolvency of the Navigators Group to the Department for review.  The Company has complied with this recommendation.	27

<u>ITEM</u>		<u>PAGE NO.</u>
iii.	It is recommended that the Company age its reinsurance recoverables in accordance with the guidelines set forth in the annual statement instructions for Schedule F.  The Company has complied with this recommendation.	28
iv.	It is recommended that Navigators not include assumed reinsurance losses as an offset to reinsurance recoverable in Schedule F, Part 5, Column 6.  The Company has complied with this recommendation.	28
v.	It is recommended, that in the future, that the Company obtain any funds held by its managing agent from draw downs on letters of credit and deposit them in its own account to receive the proper credit for reinsurance recoverable.  The Company has complied with this recommendation.	29

## **7. SUMMARY OF COMMENTS AND RECOMMENDATIONS**

<u>ITEM</u>		<u>PAGE NO.</u>
	Reinsurance	
A	It is recommended that the Company continue its efforts to amend all of its outstanding letters of credit to indicate the sole beneficiary as "Navigators Insurance Company" pursuant to the provisions of Department Regulation 133.	12

Respectfully submitted,

\_\_\_\_\_  
James Murphy  
Associate Insurance Examiner

STATE OF NEW YORK     )  
                                  )SS:  
                                  )  
COUNTY OF NEW YORK )

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

\_\_\_\_\_/S/  
James Murphy

Subscribed and sworn to before me

this \_\_\_\_\_ day of \_\_\_\_\_, 2007.

*Appointment No 22424*

**STATE OF NEW YORK  
INSURANCE DEPARTMENT**

*I, HOWARD MILLS, Superintendent of Insurance of the State of New York,  
pursuant to the provisions of the Insurance Law, do hereby appoint:*

**James Murphy**

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

**NAVIGATORS INSURANCE COMPANY**

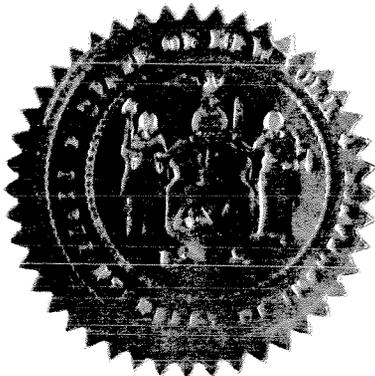
*and to make a report to me in writing of the condition of the said*

**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 New York,*

*this 13th day of October, 2005*



*Howard Mills*

HOWARD MILLS

Superintendent of Insurance