

REPORT ON EXAMINATION  
OF THE  
FINANCIAL STRUCTURES INSURANCE COMPANY  
AS OF  
DECEMBER 31, 2001

DATE OF REPORT

JANUARY 27, 2003

EXAMINER

LU ANN THERRELL

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

George E. Pataki  
Governor

Gregory V. Serio  
Superintendent

January 27, 2003

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

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 21865, dated May 7, 2002, attached hereto, I have made an examination into the condition and affairs of the Financial Structures Insurance Company as of December 31, 2001 and submit the following report thereon.

The examination was conducted at the Company's administrative office located at 9300 Arrowpoint Boulevard, Charlotte, North Carolina 28201.

The Company's statutory home office is located at One Chase Plaza, 38th Floor, New York, New York 10005.

Wherever the designation the "Company" appears herein without qualification, it should be understood to mean the Financial Structures Insurance Company.

Whenever the designation the “Department” appears herein without qualification, it should be understood to mean the New York Insurance Department.

## 1. SCOPE OF EXAMINATION

The previous examination was conducted as of September 3, 1997. This examination covers the period from September 4, 1997 through December 31, 2001. 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, 2001, a review of income and disbursements deemed necessary to accomplish such verification and utilized to the extent deemed appropriate, work performed by the Company's independent certified public accountants. A review or audit was also made of the following items as called for in the Financial Condition Examiners Handbook of the National Association of Insurance Commissioners:

- History of the Company
- Management and control
- Corporate records
- Fidelity bonds and other insurance
- Territory and plan of operation
- Growth of Company
- Reinsurance
- Accounts and records
- Financial statements

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 on October 25, 1996 and commenced business on September 18, 1997. The Company is a wholly-owned subsidiary of Financial Structures Limited, an insurance company domiciled in Bermuda. The Company is an indirect wholly-owned subsidiary of Royal Group, Inc. The ultimate parent is Royal & SunAlliance Insurance Group plc, a United Kingdom company. Financial Structures Limited was acquired by Royal & SunAlliance Insurance Group plc, from Pitney Bowes, Inc., on July 1, 1998. As of December 31, 2001 the capital structure of the Company consisted of 100 shares of issued and outstanding \$10,000 par value per share common stock that resulted in paid in capital of \$1,000,000.

### 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. As of December 31, 2001, the board of directors was comprised of thirteen members.

The Directors as of December 31, 2001 were as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Terry Broderick Charlotte, NC	President and Chief Executive Officer, Royal Insurance
Andrea Duszenczuk East Amherst, NY	Segment Underwriting Manager – Syracuse, NY, Royal Insurance
Joseph F. Fisher Charlotte, NC	Senior Vice President and Chief Financial Officer, Royal Insurance
Ernest Frohboese Charlotte, NC	Senior Vice President and Chief Investment Officer, Royal Insurance
Susan Kesselman Bedminister, NJ	Vice President, Royal Insurance

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Michael McGinley Charlotte, NC	Senior Vice President and Chief Claim Officer, Royal Insurance
Thomas McMahon New York, NY	Vice President, Royal Insurance
Stephen Mulready Wethersfield, CT	Senior Vice President, Royal Insurance
Daniel Reppert Fort Mill, SC	Senior Vice President, Royal Insurance
Paul H. Stewman Charlotte, NC	Executive Vice President, Royal Insurance
John Tighe Charlotte, NC	Senior Vice President, Royal Insurance
Joyce W. Wheeler Charlotte, NC	Senior Vice President, Chief Corporate Officer and General Counsel, Royal Insurance
James Williams, III Charlotte, NC	Senior Vice President and Chief Information Officer, Royal Insurance

The minutes of all meetings of the board of directors' and committees thereof held during the examination period were reviewed. Three of the board members, Andrea Duszenczuk, Susan Kesselman and Thomas McMahon failed to attend any of the meetings, except Andrea Duszenczuk, who was teleconferenced in during one of the four meetings held during the examination period. Members of the board have a fiduciary responsibility and must evince an ongoing interest in the affairs of the insurer. It is essential that board members attend meetings consistently and set forth their views on relevant matters so that appropriate policy decisions may be reached by the board. Individuals who fail to attend at least one-half of the board's regular meetings do not fill such criteria. Board members who are unable or unwilling to attend meetings consistently should resign or be replaced.

In accordance with Section 1201(a)(5)(B)(vi) of the New York Insurance Law, the Company's charter states that of the directors of the Company, "not less than three shall be residents of this state". The list of directors provided by the company indicates two of the directors, Andrea J. Duszenczuk and Thomas McMahon reside in New York. It is recommended that the Company comply with Section 1201(a)(5)(B)(vi) of the New York Insurance Law, Section 8 of the Company's charter and Article III, Section 2 of the Company's by-laws by ensuring that not less than three members of its board of directors be residents of the State of New York.

The principal officers of the Company as of December 31, 2001, were as follows:

<u>Name</u>	<u>Title</u>
Terry Broderick	President and Chief Executive Officer
Paul H. Stewman	Executive Vice President
Joseph F. Fisher	Senior Vice President and Chief Financial Officer
Ernest C. Frohboese	Senior Vice President and Chief Investment Officer
Michael J. McGinley	Senior Vice President and Chief Claim Officer
Stephen M. Mulready	Senior Vice President
Daniel A. Reppert	Senior Vice President
John Tighe	Senior Vice President
Joyce W. Wheeler	Senior Vice President, Chief Corporate Officer, & General Counsel
James G. Williams, III	Senior Vice President and Chief Information Officer

B. Territory and Plan of Operation

The Company is licensed to write business only in New York. Since the Company commenced business it has not written any direct business.

As of December 31, 2001, 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>
16	Fidelity and surety
17	Credit
22	Residual value
26A	Motor vehicle lessor/creditor gap
26B	Motor vehicle lessee/debtor gap
26C	Non-motor vehicle lessor/creditor gap
26D	Non-motor vehicle lessee/debtor gap

Based upon 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 \$5,400,000.

C. Reinsurance

The only business written by the Company is business assumed from its parent, Financial Structures, Limited. Pursuant to a reinsurance agreement, the Company accepts a variable quota share of up to 100% up to a limit of liability of the lesser of \$1,500,000 or 10% of the policyholders' surplus of the Company as shown on the last preceding annual or quarterly statement to the New York Insurance Department. The agreement was effective December 5, 1997 and is still in effect.

Since 1997, the Company has only assumed reinsurance related to one residual value insurance policy in which the insured is Pitney Bowes Credit Corporation. As mentioned previously, Pitney Bowes, Inc. was the former ultimate owner of Financial Structures Limited. This policy expires in 2012.

The Company has submitted an amendment to the New York Insurance Department to terminate this reinsurance agreement effective October 1, 2002.

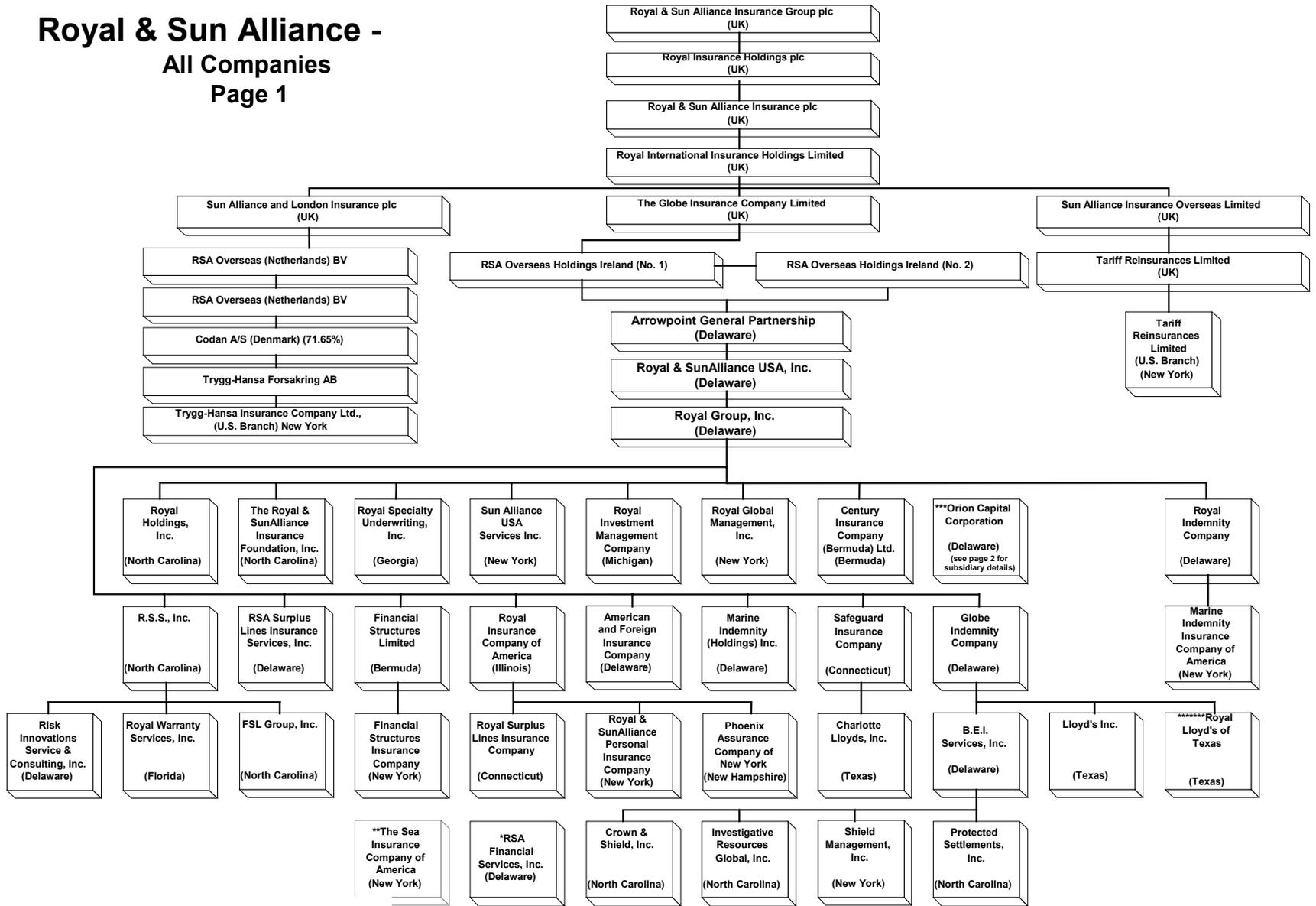
D. Holding Company System

The Company is a wholly-owned subsidiary of Financial Structures Limited, ultimately owned by Royal & Sun Alliance Insurance Group plc.

A review was made of the filings submitted by the Company pursuant to the requirements and standards set forth for holding company organizations under Article 15 of the New York Insurance Law and Department Regulation 52.

The following chart shows the position of the Company in the holding company system as of December 31, 2001:

# Royal & Sun Alliance - All Companies Page 1

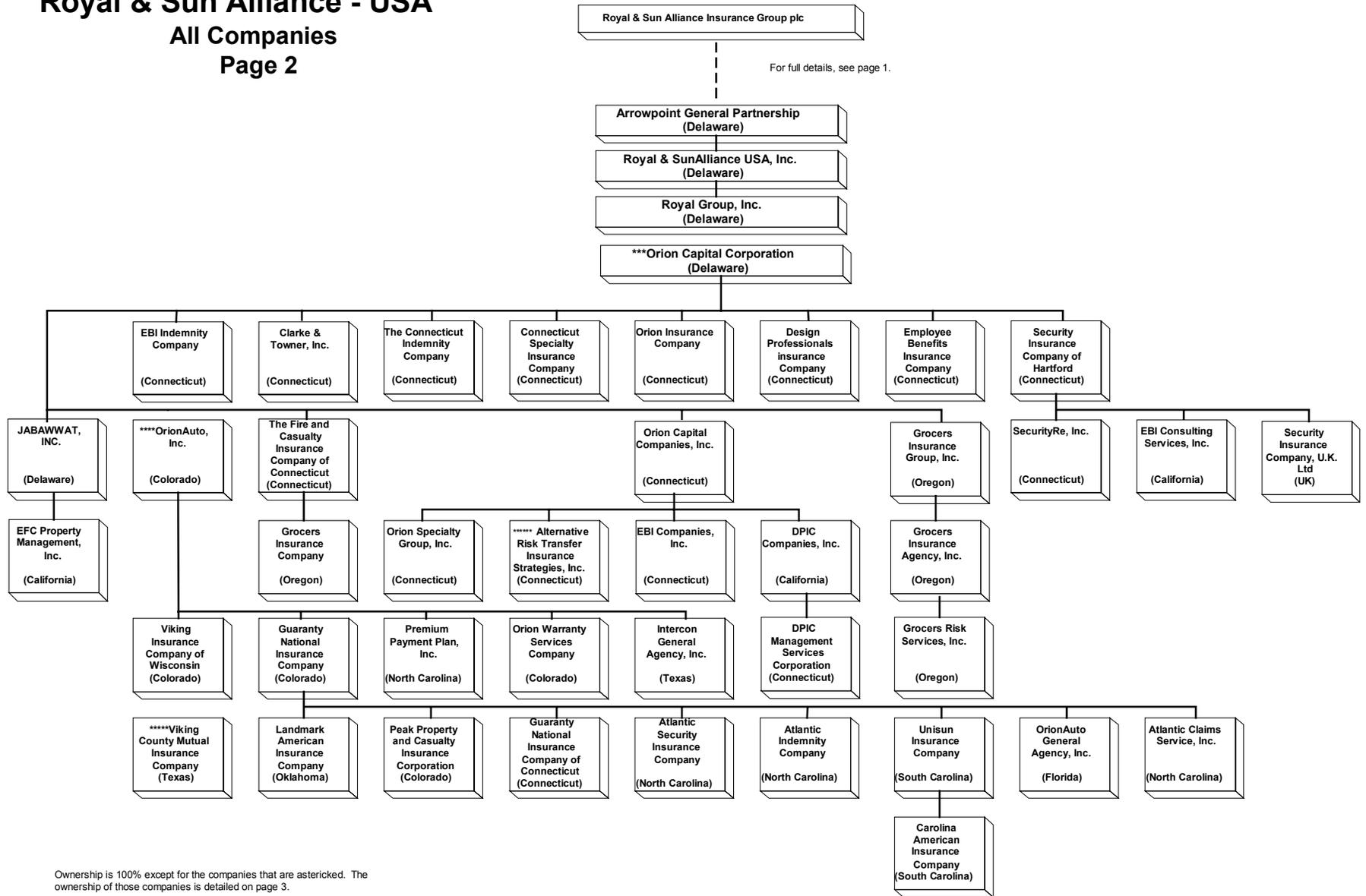


Ownership is 100% except for the companies that are astericked. The ownership of those companies is detailed on page 3.

# Royal & Sun Alliance - USA

## All Companies

### Page 2



Ownership is 100% except for the companies that are astericked. The ownership of those companies is detailed on page 3.

# Royal & Sun Alliance - USA

## All Companies

### Page 3

Ownership of the Royal & SunAlliance companies is 100% except for the following:

\*RSA Financial Services, Inc.:

Royal Indemnity Company - 42.9%  
Royal Insurance Company of America - 23.8%  
Globe Indemnity Company - 13.6%  
Safeguard Insurance Company - 12.3%  
American and Foreign Insurance Company - 7.4%

\*\*The Sea Insurance Company of America:

Royal Insurance Company of America - 40.0%  
Royal Indemnity Company - 37.0%  
Safeguard Insurance Company - 10.0%  
American and Foreign Insurance Company - 7.0%  
Globe Indemnity Company - 6.0%

\*\*\*Orion Capital Corporation:

Royal Group, Inc. - 89.4%  
EFC Property Management, Inc. - 2.4%  
Royal Insurance Company of America - 1.8%  
The Connecticut Indemnity Company - 1.5%  
SecurityRe, Inc. - 1.4%  
Royal Indemnity Company - 1.2%  
The Fire and Casualty Insurance Company of Connecticut - 0.6%  
Globe Indemnity Company - 0.6%  
Security Insurance Company of Hartford - 0.4%  
JABAWWAT, Inc. - 0.3%  
American and Foreign Insurance Company - 0.2%  
Safeguard Insurance Company - 0.2%

\*\*\*\*OrionAuto, Inc.:

Security Insurance Company of Hartford - 32.2%  
Royal Indemnity Company - 31.4%  
Royal Insurance Company of America - 19.9%  
American and Foreign Insurance Company - 6.6%  
Safeguard Insurance Company - 6.3%  
The Fire and Casualty Insurance Company of Connecticut - 3.6%

\*\*\*\*\* Viking County Mutual Insurance Company:

Owned by the policyholders; managed by Viking Insurance Company of Wisconsin

\*\*\*\*\* Alternative Risk Transfer Insurance Strategies, Inc.:

Orion Capital Companies, Inc. - 80%  
Royal Group, Inc. - 20%

\*\*\*\*\* Royal Lloyd's of Texas

Association of Underwriters; Globe Indemnity has Trust Agreements with the Underwriters

The Company was a party to the following holding company agreements as of December 31, 2001:

Tax Allocation Agreement

The Company's federal income tax return is included in the consolidated income tax return of Arrowpoint General Partnership, Royal & SunAlliance USA, Inc., Royal Group, Inc., and various subsidiaries. The agreement dated December 31, 1999 replaces a previously filed agreement, beginning with the 1999 tax year. The Company has indicated the tax allocation agreement dated December 31, 1999 was not submitted to the New York Insurance Department for approval as required by Section 1505 (d) of the New York Insurance Law and Department Circular Letter No. 33 (1979). Although the agreement was disclosed in the Company's HC-1 filings, disclosure in the Form B (HC-1) does not take the place of required filings pursuant to Section 1505 New York Insurance Law, and Department Circular Letter No. 33(1979).

Subsequent to the examination date, in January 2003, the Company submitted the tax allocation agreement dated December 31, 1999 to the Department. The Department non-objected to the implementation of this agreement.

Administrative Services and Expense Sharing Agreement

The Company is party to an administrative services and expense sharing agreement pursuant to which Royal Indemnity Company provides services including but not limited to financial, legal and regulatory, information services, and human resources, and allocates costs related to such services amongst the affiliated companies. The administrative services and expense sharing agreement effective January 1, 2001 was submitted to the Department in accordance with Section 1505(d) of the New York Insurance Law, and non-objected to, provided that the effective date of the agreement be no sooner than December 7, 2001. It is noted that expenses were charged to all companies from January 1, 2001.

### Investment Management Agreement

The Company is party to an investment management agreement with Royal Investment Management Company (“RIMCO”). RIMCO provides services relating to the management of the Company’s investment portfolio, subject to the investment policy statement approved by the board of directors. These services include, but are not limited to investment analysis, research and purchase and sale of investments. The Company is charged a management fee for these services based on the ledger value of the Company’s investment portfolio.

An amendment to the agreement for investment management services was entered into on September 11, 2000, by and between RIMCO and the Company, effective April 23, 1999. The amendment was made to more clearly reflect the investment management fees and indicated the payments should be made on a quarterly basis. The amendment was not submitted to the Department as required by Section 1505(d)(3) of the New York Insurance Law. Although the amendment was disclosed in the Company’s HC-1 filings, disclosure in the Form B (HC-1) does not take the place of required filings pursuant to Section 1505 of the New York Insurance Law.

Subsequent to the examination date, in January 2003, the Company submitted to the Department the amendment to the investment management agreement. The Department non-objected to the implementation of this amendment.

It is further recommended that, in the future, the Company comply with the prior notification requirements of Section 1505 of the New York Insurance Law.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2001, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	0%
Liabilities to liquid assets (cash and invested assets less investment in affiliates)	2%
Premiums in course of collection to surplus as regards policyholders	0%

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

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

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses	\$ 0	0.00%
Other underwriting expenses incurred	148,497	1,212.22
Net underwriting gain (loss)	<u>(136,247)</u>	<u>(1,112.22)</u>
Premiums earned	<u>\$12,250</u>	<u>100.00%</u>

F. Abandoned Property Law

The Company made the necessary filings as required by the provisions of Section 1316 of the New York Abandoned Property Law.

G. Accounts and Records

i) Contract with Certified Public Accountants

Department Regulation 118, Section 89.2 requires an insurer to enter into a written contract with its certified public accountant. In addition, Section 89.2 of the regulation indicates the terms that the contract must encompass. The contract received from the Company did not conform to the provisions of Regulation 118. It is recommended that the Company ensure that all future agreements with its certified public accountants contain the provisions required by Department Regulation 118.

ii) Custodial Agreements

The domestic custody agreement between Chase Manhattan Bank and Financial Structures Insurance Company, was found to be lacking the following provisions as set forth in the NAIC Financial Condition Examiners Handbook, Part 1, Section IV - H:

1. That in the event that the custodian gains entry in a clearing corporation through an agent, there should be a written agreement between the custodian and the agent that the agent shall be subjected to the same liability for loss of securities as the custodian. If the agent is governed by laws that differ from regulation of the custodian, the Commissioner of Insurance of the state of domicile may accept a standard of liability applicable to the agent that is different from the standard of liability;
2. That if the custodial agreement has been terminated or if 100% of the account assets in any one custody account have been withdrawn, the custodian shall provide written notification, within three business days of termination or withdrawal, to the insurer's domiciliary commissioner;
3. The custodian and its agents, upon reasonable request, shall be required to send all reports which they receive from a clearing corporation or the Federal Reserve book-entry system which the clearing corporation or the Federal Reserve permits to be redistributed and reports prepared by the custodian's outside auditors, to the insurance company on their respective systems of internal control;
4. That the custodian shall provide, upon written request from a regulator or an authorized officer of the insurance company, the appropriate affidavits, with respect to the insurance company's securities held by the custodian;
5. That the custodian shall secure and maintain insurance protection in an adequate amount.

It is recommended that the Company's domestic custody agreement be amended to include the provisions set forth in the NAIC Financial Condition Examiners Handbook, Part 1, Section IV-H.

iii) Investments

As of the examination date, the Company was in violation of Section 1409(a) of the New York Insurance Law, which limits investments in any one institution to ten percent of the insurers' admitted assets. Based on review of Schedule D-Part 1 at December 31, 2001, the Company owned two securities in Federated Department Stores amounting to \$2,007,358, which represents 11.6% of the Company's admitted assets at December 31, 2001. It is recommended that the Company comply with the requirements of Section 1409(a) of the New York Insurance Law.

Subsequent to the examination date, the Company disposed of its excess investment in Federated Department Stores. No changes have been made to the financial statements herein due to the subsequent disposal of the excess investment.

### 3. FINANCIAL STATEMENTS

#### A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as determined by this examination, as of December 31, 2001. This statement is the same as the balance sheet filed by the Company:

	<u>Assets</u>	Non-Admitted <u>Assets</u>	Net Admitted <u>Assets</u>
Bonds	\$15,947,002	\$	\$15,947,002
Cash and short-term investments	1,081,142		1,081,142
Premiums and agents' balances in course of collection	313		313
Interest, dividends and real estate income due and accrued	<u>264,595</u>	_____	<u>264,595</u>
Total assets	<u>\$17,293,052</u>	\$ _____	<u>\$17,293,052</u>

Liabilities, Surplus and Other Funds

Losses and loss adjustment expenses		\$	0
Federal and foreign income taxes			386,327
Unearned premiums			28,999
Payable to parent, subsidiaries and affiliates			<u>2,641</u>
Total liabilities			\$417,967
Common capital stock	\$1,000,000		
Gross paid in and contributed surplus	14,000,000		
Unassigned funds (surplus)	<u>1,875,085</u>		
Surplus as regards policyholders			<u>16,875,085</u>
Total liabilities, surplus and other funds			<u>\$17,293,052</u>

Note: The Internal Revenue Service ("IRS") is currently auditing the 1997 and 1998 tax years and has begun the review of the 1999 and 2000 years. Although the Company is part of the consolidated income tax return, the IRS focuses on the companies that are part of the pool. No adjustments have been made to date for any of the non-pool companies for the tax years 1997-2000. The audit for the 2001 tax year has not been scheduled. The examiner is unaware of any potential exposure of the Company to any further tax assessment and no liability has been established relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$1,875,085 during the four-year examination period, September 4, 1997 through December 31, 2001 detailed as follows:

Statement of Income

Premiums earned		\$ 12,250
Deductions:		
Losses and loss adjustment expenses incurred	\$0	
Other underwriting expenses incurred	<u>148,497</u>	
Total underwriting deductions		<u>148,497</u>
Net underwriting (loss)		\$ (136,247)
 <u>Investment Income</u>		
Net investment income earned	\$ 3,783,656	
Net realized capital (losses)	<u>(747,082)</u>	
Net investment gain		<u>3,036,574</u>
Net income, after dividends to policyholders and before federal and foreign income taxes		\$ 2,900,327
Federal and foreign income taxes incurred		<u>1,025,242</u>
Net Income		<u>\$ 1,875,085</u>

Capital and Surplus Account

Surplus as regards policyholders, September 3, 1997, per report on organization			\$15,000,000
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	<u>\$1,875,085</u>	_____	
Total gains and losses	<u>\$1,875,085</u>	<u>\$ 0</u>	
Net increase in surplus as regards policyholders			<u>1,875,085</u>
Surplus as regards policyholders, December 31, 2001 per report on examination			<u>\$16,875,085</u>

**4. LOSSES AND LOSS ADJUSTMENT EXPENSES**

The examination liability of \$-0- is the same as the amount reported by the Company as of December 31, 2001. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices. Since the Company commenced business, no loss or loss adjustment expenses have been paid. As noted in Item 2C, the only business written by the Company has been reinsurance assumed under one residual value insurance policy.

## 5. MARKET CONDUCT ACTIVITIES

The Company wrote no direct business during the period under examination; therefore, no market conduct procedures were performed.

## 6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report was an organizational report and contained no comments and recommendations.

## 7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
i. It is recommended board members who are unable or unwilling to attend meetings consistently resign or be replaced.	4
ii. It is recommended that the company comply with Section 1201(a)(5)(B)(vi) of the New York Insurance Law, Section 8 of the Company's charter and Article III Section 2 of the Company's by-laws by ensuring that not less than three members of its board of directors be residents of the State of New York.	5
B. <u>Holding Company System</u>	
It is recommended that in the future, the Company comply with the prior notification requirements of Section 1505 of the New York Insurance Law.	12
C. <u>Accounts and Records</u>	
i. It is recommended that the Company ensure that all future agreements with its certified public accountants contain the provisions required by Department Regulation 118.	14
ii. It is recommended that the domestic custody agreement be amended to include provisions set forth in the NAIC Financial Condition Examiners Handbook, Part 1, Section IV-H.	15

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- iii. It is recommended that the Company comply with the requirements of Section 1409(a) of the New York Insurance Law. Subsequent to the examination date, the Company disposed of its excess investment in Federated Department Stores.

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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:

**LuAnn Therrell**

as proper person to examine into the affairs of the

**FINANCIAL STRUCTURES INSURANCE COMPANY**

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

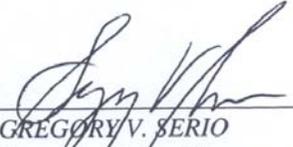
**Company**

with such other information as she shall deem requisite.

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

this 7th day of May, 2002



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