

REPORT ON EXAMINATION

OF THE

BOLTON INSURANCE COMPANY

AS OF

DECEMBER 31, 2007

DATE OF REPORT

DECEMBER 5, 2008

EXAMINER

VERONICA DUNCAN BLACK

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

December 5, 2008

Honorable Eric R. Dinallo
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 30212 dated October 2, 2008 attached hereto, I have made an examination into the condition and affairs of Bolton Insurance Company as of December 31, 2007, and submit the following report thereon.

Wherever the designations "the Company" appears herein without qualification, it should be understood to indicate Bolton 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 Department's offices located at 25 Beaver Street, New York, NY 10004.

1. SCOPE OF EXAMINATION

The purpose of this examination was to determine whether the Company was operating within its by-laws, was conforming to Article 70 of the New York Insurance Law, and was in compliance with its plan of operation as submitted to the Department.

A review was conducted of the Company's operations, from its date of incorporation as a New York captive insurance company, December 31, 2003 through December 31, 2007. The review included an analysis of the Company's financial condition, the corporate records, and limited tests of the various income and disbursement items as deemed necessary. This report is submitted on an "exception" basis. Comments and recommendations are limited to those items requiring financial adjustment, procedural recommendations, or instances where the Company was not conforming to the application submitted to the Department or Article 70 of the New York Insurance Law.

The report utilized work performed by the Company's independent certified public accountants to the extent considered appropriate.

2. DESCRIPTION OF COMPANY

The Company was incorporated and licensed on December 31, 2003 and commenced operations as a captive insurance company under the laws of the state of New York on January 1, 2004. The Company is a wholly-owned subsidiary of ITT Corporation ("ITT"), a global engineering and manufacturing company specializing in as a supplier of pumps, systems and services to move, control and treatment of water and other fluids.

A. Articles of Incorporation

The purpose of the Company, as stated in its articles of incorporation, was to form a corporation for the purpose of transacting the kinds of insurance specified in Section 1113 of the New York Insurance Law, subject at all times to the limitations on the business of pure captive insurance companies set forth in Article 70 of the New York Insurance Law.

B. By-Laws

The by-laws of the Company were reviewed and it was noted that the Company was operating in full conformity with its by-laws in all material respects except as noted in Section 2.G herein.

C. Capital Structure

The Company was incorporated as a pure captive insurance Company. On December 31, 2003, the Company issued 100,000 shares of \$1 par value per share common stock in exchange for an irrevocable letter of credit totaling \$7,741,000 to its parent company, ITT. It is noted that per the license application, the amount of the letter of credit was supposed to be \$7,471,000. During 2004, the letter of credit was cancelled after the issuance of a promissory note of \$7,221,000 and payment of \$250,000 to the Company from ITT. At that time, paid in and contributed surplus was reduced by \$270,000 to \$7,371,000 to reflect the correct level of capitalization per the license application.

Gross paid in and contributed surplus decreased by \$270,000 during the examination period, as follows:

<u>Year</u>	<u>Description</u>	<u>Amount</u>
2003	Beginning gross paid in and contributed surplus	\$7,641,000
2004	Surplus reduction	<u>\$270,000</u>
	Total Surplus reduction	<u>270,000</u>
2007	Ending gross paid in and contributed surplus	<u>\$7,371,000</u>

D. Corporate Records

The corporate records reviewed appeared to be substantially accurate and complete in all material respects.

E. Plan of Operation

The Company's plan of operation states that it will provide its parent company, ITT Industries and all of its domestic subsidiaries with insurance coverage as permitted by Article 70 of the New York Insurance Law. The business plan states that the Company will provide workers compensation, general liability and automobile liability risks of the group. Beginning on January 1, 2005, the Company began assuming the first \$500,000 of loss on certain ITT property business originally written by a third party insurer.

F. Reinsurance

The Company participated in one assumed reinsurance agreement for the period ended December 31, 2007. Pursuant to the terms of the reinsurance agreement, the Company agreed to accept 100% of the first \$500,000 per occurrence for insurance related to its parent company's property business. The contract contained the required standard clauses including an insolvency clause which meets the requirements of Section 1308 of the New York Insurance Law.

For the period under examination, the Company entered in two assumed reinsurance agreements with a third party insurer who held property insurance policies with its parent company, ITT. The first agreement was a novation agreement in which the Company assumed reserves totaling \$445,000 for consideration of \$656,011. The consideration was recorded as written and earned on the effective date of the agreement, January 1, 2005. The reserves are relates to policies originally written in 2003. The second agreement prospectively covers similar business for policy period January 1, 2005 to December 31, 2005. Effective January 1, 2006, the Company renewed the prospective assumed coverage for policy period 2006 and subsequently renewed such agreement for policy period 2007.

The Company did not engage any ceded reinsurance arrangements for the period under examination.

G. Management

Captive Manager

The Company is managed by Aon Insurance Managers (USA) Inc., ("AIM") a Vermont corporation. Effective January 7, 2004, Thomas P. Stokes was licensed as a captive manager on the behalf of AIM pursuant to Section 7003(b)(4)(B) of the New York Insurance Law.

Effective January 1, 2004, the Company executed a captive services agreement with AIM. The agreement requires AIM to perform certain consulting and administrative services in connection with the operations of the Company, including maintaining the books and the records of the Company, assisting with certain underwriting functions, and administrating the day to day activities of the Company.

Board of Directors

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of not be less than three, but nor more than ten members. At December 31, 2007, the board of directors was comprised of the following three members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Donald E. Foley Cos Cob, CT	President and Director, ITT Corporation
Clayton Young New York, NY	Treasurer and Director, ITT Corporation
Vincent A. Mafeo New Canaan, CT	Director, ITT Corporation

The board met four times during the period covered by this examination. A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended, with the exception of Vincent A. Maffeo, who attended less than 50% of the meetings for which he was eligible to attend.

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 the board may reach appropriate decisions. Individuals who fail to attend at least one-half of the regular meetings do not fulfill such criteria. It is recommended that board members who are unable or unwilling to attend meetings consistently should resign or be replaced.

The Company's charter and by-law provides that at least two members of the directors shall be residents of the State of New York. A review of the board of directors' residency requirements shows that only one of the Company's directors resided in the state of New York for calendar years 2004 through 2007. This review shows that the Company was not in compliance with its charter and by-laws as well as Section 7005(g) of the New York Insurance Law, which requires that the captive insurer have at least two members of the board of residents of the State of New York. It is recommended that the Company comply with its charter and by-laws and Section 7005(g) of the New York Insurance Law by requiring that at least two of its directors be residents of the state of New York.

As of December 31, 2007, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Donald E. Foley	President
Valerie M. Doyle	Secretary
Clayton Young	Treasurer

H. Certified Public Accountant (“CPA”) and Actuarial Services

The Company was audited by Deloitte and Touche LLP for the years covered by this examination. Francois R. Dumontet of Aon Global Risk Consulting provides actuarial services for the Company. The Company filed its certified public accountant’s financial statements annually on or before July 1st for all of the years under examination.

I. Growth of Company

The following schedule sets forth the Company’s significant summary financial information for the years covered by this examination:

<u>Year</u>	<u>Net Premiums Earned</u>	<u>Net Income/(Loss)</u>	<u>Assets</u>	<u>Capital and Surplus</u>
2003	\$ 0	\$ 0	\$ 7,741,000	\$7,741,000
2004	\$17,097,881	\$ (26,281)	\$20,623,177	\$7,444,719
2005	\$21,594,763	\$ (1,369,831)	\$33,187,064	\$6,074,888
2006	\$23,266,203	\$ (279,290)	\$45,702,024	\$5,795,598
2007	\$21,457,140	\$ (1,769,812)	\$59,361,323	\$4,025,786

3. FINANCIAL STATEMENTS

A. Balance Sheet

The financial statements of the Company are presented in conformity with generally accepted accounting principles. The financial position of the Company as presented and accepted was audited by the Company's certified public accountant:

Balance Sheet As of December 31, 2007

Asset

Cash	\$ 21,867
Other invested assets – Mutual funds	17,156,543
Accounts and premiums receivable	2,150,104
Investments in and advances to affiliates	37,221,000
Deferred tax asset	2,622,583
Tax receivable	<u>189,226</u>
Total assets	<u>\$59,361,323</u>

Liabilities, Capital and Surplus

Liabilities

Losses	\$45,558,521
Loss adjustment expense	6,285,552
Commissions, expenses and fees	12,194
Funds held under reinsurance contracts	472,463
Accounts payable	71,393
Losses payable	546,070
Premiums payable	<u>2,389,344</u>
Total liabilities	\$55,335,537

Capital and Surplus

Paid in capital	\$ 100,000
Contributed surplus	7,371,000
Surplus (accumulated earnings)	<u>(3,445,214)</u>
Total capital and surplus	<u>4,025,786</u>
Total liabilities, capital and surplus	<u>\$59,361,323</u>

B. Statement of Income

Capital and surplus decreased \$3,715,214 during the five-year examination period, December 31, 2003 through December 31, 2007.

Underwriting Income

Net premiums earned		\$ 83,415,987
<u>Underwriting Expense</u>		
Net losses incurred	\$66,466,682	
Net loss adjustment expense	9,875,513	
Commission and brokerage	2,005,105	
General and administrative	472,288	
Other underwriting expense	<u>15,097,973</u>	
Total underwriting expense		<u>93,917,561</u>
Underwriting profit(loss)		\$ (10,501,574)
Investment Income (net)		<u>5,201,246</u>
Income before dividends and taxes		\$ (5,300,328)
Taxes		<u>(1,855,114)</u>
Net loss		\$ <u>(3,445,214)</u>

Capital and Surplus Account

Capital and surplus at December 31, 2003			\$ 7,741,000
	<u>Increase</u>	<u>Decrease</u>	
Net loss	\$	\$3,445,214	
Surplus adjustments	<u>0</u>	<u>270,000</u>	
Total increases and decreases	\$ <u>0</u>	<u>\$3,715,214</u>	
Net decrease in surplus			<u>3,715,214</u>
Capital and surplus, per report on Examination as of December 31, 2007			<u>\$ 4,025,786</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The Company reported losses and loss adjustment expenses of \$51,884,073 as of December 31, 2007. The examiner did not independently review the loss reserves but rather relied upon the opinion of Francois R. Dumontet, the Company's actuary and Steven Visner and Peter Tomopoulous, the Company's CPA actuaries. Based upon the actuarial opinion, no changes have been made to the reserves reported by the Company. The actuaries agree that the Company's reserves are within a reasonable range and believe that the Company has made a reasonable provision for its unpaid loss and loss expense obligation as of December 31, 2007.

The Company's CPA actuaries noted that the Company experienced an unreasonable reporting lag of property claims for the first few years of the program. A review by the actuaries shows that the reporting lag time for these claims has subsided. The actuaries, however, noted from their review that one large claim in policy year 2006 with a loss date of December 15, 2006 was not included in the property claims as of December 2006 and April 2007. This claim was not reported until June 2007. Although the reporting lag time had been remediated considerably since the occurrence of this claim, the CPA recommended that the Company, the parent Company – ITT, and the captive manager – AON Insurance Managers continue to closely monitor the reporting of property losses to the Company in the future by regularly reviewing the property loss runs provided by the ceding company. This examination reiterates the CPA's recommendation with regard to the Company taking the necessary step to monitor the reporting of its property losses.

5. ARTICLE 70 COMPLIANCE

Article 70 of the New York State Insurance Law is the governing law for the formation and continued operation of Captive Insurance Companies in New York State. A review was performed to test the Company's compliance with Article 70. Such review shows that the Company met its compliance with Article 70, except for Section 7005(g) of the New York Insurance Law. This area is discussed in Section 2.G herein.

6. INSURANCE PROGRAM

The Company was established to write indemnification liability policies. The Company has written separate contractual liability policies for workers compensation, automobile liability and general liability insuring its parent company, ITT. The Company's liability under these policies is limited solely to indemnifying ITT for losses and loss expense for which ITT has accepted responsibility arising out of its obligations for deductible amounts contained in any scheduled commercial insurance policy. The policies also indemnify ITT for broker fees incurred in connection with the administrative and services of its obligations. Each policy agrees to indemnify ITT for up to \$1,000,000 of ultimate net loss per occurrence during each policy period. The Company also participates in an assumed reinsurance program. The reinsurance program is discussed in Section F herein.

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management – Board of Directors</u>	
i. It is recommended that the board members who are unable or unwilling to attend meetings consistently should resign or be replaced.	5
ii. It is recommended that the Company comply with charter and by-laws and Section 7005(g) of the New York Insurance Law by requiring that at least two of its directors be residents of the state of New York.	6
B. <u>Losses and Loss Adjustment Expense</u>	
This examination reiterates the CPA's recommendation in regard to the Company taking the necessary steps to monitor the reporting of its property losses.	9

Appointment No. 30212

**STATE OF NEW YORK
INSURANCE DEPARTMENT**

*I, Eric R. Dinallo, Superintendent of Insurance of the State of New York,
pursuant to the provisions of the Insurance Law, do hereby appoint:*

Veronica Duncan Black

as proper person to examine into the affairs of the

BOLTON 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 2nd of October, 2008



A handwritten signature in black ink, reading "Eric R. Dinallo".

ERIC R. DINALLO
Superintendent of Insurance