

REPORT ON EXAMINATION

OF THE

SYNCORA CAPITAL ASSURANCE INC.

AS OF

DECEMBER 31, 2011

DATE OF REPORT

MAY 21, 2013

EXAMINER

MARIBEL C. NUÑEZ, C.P.C.U

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NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Benjamin M. Lawsky
Superintendent

May 21, 2013

Honorable Benjamin M. Lawsky
Superintendent of Financial Services
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 30765 dated December 2, 2011, attached hereto, I have made an examination into the condition and affairs of Syncora Capital Assurance Inc. as of December 31, 2011, and submit the following report thereon.

Wherever the designation “the Company” appears herein without qualification, it should be understood to indicate Syncora Capital Assurance Inc.

Wherever the term “Department” appears herein without qualification, it should be understood to mean the New York State Department of Financial Services.

The examination was conducted at the Company’s home office located at 135 West 50th Street, New York, New York 10020.

1. SCOPE OF EXAMINATION

The Department has performed an individual examination of Syncora Capital Assurance Inc., a single-state insurer. This is the first financial examination of the Company after the report on organization, which was conducted as of July 15, 2009. This examination covered the period from July 15, 2009 through December 31, 2011. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”), which requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management’s compliance with Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All accounts and activities of the Company were considered in accordance with the risk-focused examination process. This examination also included a review and evaluation of the Company’s own control environment assessment. The examiners also relied upon audit work performed by the Company’s independent public accountants when appropriate.

This examination report includes a summary of significant findings for the following items as called for in the Handbook:

- Significant subsequent events
- Company history
- Corporate records
- Management and control
- Fidelity bonds and other insurance
- Territory and plan of operation
- Loss experience
- Reinsurance
- Accounts and records
- Financial statements
- Summary of recommendations

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

2. DESCRIPTION OF COMPANY

Syncora Capital Assurance Inc. was incorporated under the laws of the State of New York on April 1, 2009 as a wholly-owned subsidiary of Syncora Guarantee Inc. (“Parent”), a New York domiciled financial guaranty insurance company formerly known as XL Capital Assurance Inc. It was licensed on April 1, 2009 and commenced business on July 15, 2009. The sole purpose for the formation of the Company was to reinsure certain of the Parent’s public finance business and certain of its global infrastructure business pursuant to a quota share reinsurance agreement, under which the Company paid the Parent an amount equal to ceded unearned premium net of a 17.5% ceding commission, and to assume certain of the Parent’s insurance policies covering existing credit default swaps between affiliates of the Parent and certain financial counterparties pursuant to an assumption reinsurance and novation agreement.

As of December 31, 2011, Capital paid in was \$2,500,000 consisting of 2,500 shares of \$1,000 par value per share common stock. Gross paid in and contributed surplus was \$189,000,000. Gross paid in and contributed surplus has not changed since its organization.

A. Management

Pursuant to the Company’s charter and by-laws, management of the Company is vested in a board of directors consisting in no less than thirteen, or more than nineteen members. As of the examination date, the Board of Directors was comprised of the following thirteen members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Susan Comparato Glen Ridge, NJ	Chief Executive Officer and President, Syncora Guarantee Inc
Michael Patrick Esposito, Jr. Longboat Key, FL	Retired

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
William Martin Fitzgerald, Sr. Kenilworth, IL	Founder, Global Infrastructure LLC.
Edmund Graham Gibbons Hamilton Parish, Bermuda	Member of Parliament – Bermuda, Bermuda Government
Duncan Pratt Hennes Rye, NY	Partner, Atrevida Partners, LLC
Robert Martin Lichten Jupiter, FL	Co-Chairman, Inter-Atlantic Securities Corp.
Donald John Matthews Far Hills, NJ	Retired
Thomas Stanley Norsworthy Bethel, CT	Chief Executive Officer, Lincoln General Insurance Company
Frank Charles Puleo Park City, UT	Retired
Coleman DeVane Ross Chapel Hill, NC	Retired
Robert Wright Shippee Greenwich, CT	Credit Risk Consultant, Straumur Investment Bank
Robert Sterling Strong New Vernon, NJ	Retired
Robert Joel White Los Angeles, CA	Director, Ascend Media LLC

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 had an acceptable record of attendance.

As of December 31, 2011, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Susan Comparato	President & Chief Executive Officer
Claude LeBlanc	Chief Financial Officer
John Francis Garrity	Controller

B. Territory and Plan of Operation

As of December 31, 2011, the Company was licensed to write business in New York only, and was licensed as an Accredited Reinsurer in Kentucky, Idaho, and Michigan.

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>
16 (C)(D)(E)(F)	Fidelity and surety
25	Financial guaranty

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, 41 and 69 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$66,000,000.

The Company is prohibited from writing new business; it operates as a reinsurer for its parent company. However, due to the nature of the financial guaranty business, premiums are still being received from in-force business.

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 United States</u>	<u>Premiums Written in New York State as a percentage of United States Premium</u>
2009	\$33,490,402	\$33,490,402	100.00%
2010	\$32,445,101	\$32,445,101	100.00%
2011	\$29,090,851	\$29,090,851	100.00%

The Company provided financial guaranty insurance and reinsurance for asset-backed, future flow and municipal obligations. Financial guaranty insurance provides an unconditional and irrevocable guarantee to the holder of a debt obligation of full and timely payment of the guaranteed principal and interest.

C. Reinsurance

Assumed reinsurance accounted for 28.98% of the Company's gross premium written at December 31, 2011.

All of the Company's assumed business derives from 100% quota share and assumption reinsurance and novation agreements each effective July 15, 2009 with its parent company Syncora Guaranty Inc. ("SGI"). These agreements were part of the Master Transaction Agreement, which is more fully described in Item 2D of this report. Under the 100% quota share agreement, the Company assumes 100% of certain of SGI's public finance business and certain global infrastructure business. Under the assumption reinsurance and novation agreement, the Company assumes through novation certain of SGI's non-public finance and non-commuted policies on CDS contracts.

The Company utilizes reinsurance accounting as defined in Statement of Statutory Accounting Principle ("SSAP") No. 62 for all of its assumed reinsurance business.

Ceded

Facultative Reinsurance Agreement

The Company's ceded reinsurance program consists of one master facultative reinsurance agreements with Assured Guaranty Re International Ltd., whereby the Company cedes to the reinsurer the share of a risk(s) insured by the Company as specified and agreed to by the parties in a reinsurance memorandum.

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.

It is the Company's policy to obtain the appropriate collateral for its cessions to unauthorized reinsurers. Trust accounts obtained by the Company to take credit for cessions to unauthorized reinsurers were reviewed for compliance with Department Regulations 114. No exceptions were noted.

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.

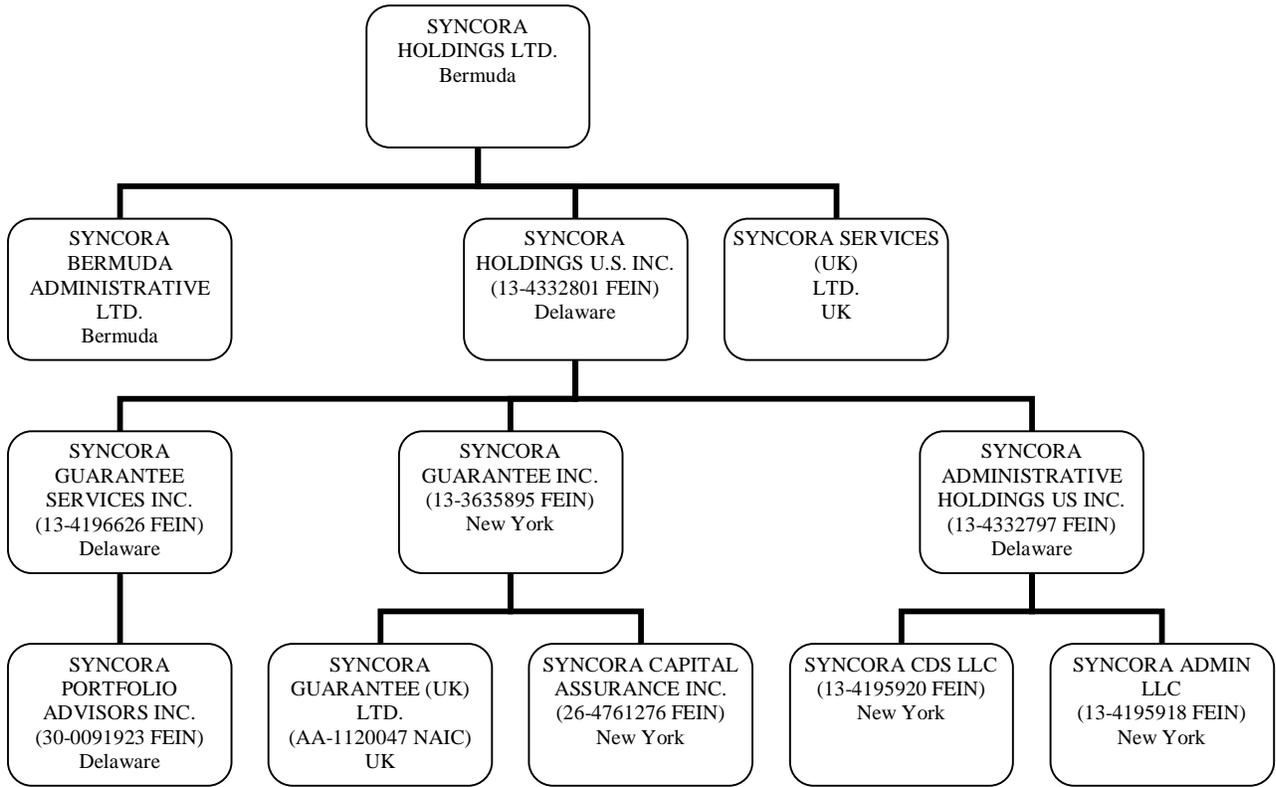
Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Examination review indicated that the Company was not a party to any finite reinsurance agreements. All ceded reinsurance agreements were accounted for utilizing reinsurance accounting as set forth in SSAP No. 62. The Company's Chief Executive Officer did not file the reinsurance attestation pursuant to the NAIC Annual Statement Instructions representing that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62. Therefore, it is recommended that the Company file the reinsurance attestation as indicated in the Annual Statement Instructions.

D. Holding Company System

The Company is 100% owned by Syncora Guarantee Inc. ("SGI"), which in turn is wholly-owned by Syncora Holdings U.S. Inc., a Delaware domiciled company, which is ultimately controlled by Syncora Holdings Ltd., a Bermuda holding company.

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.

The following is a chart of the holding company system at December 31, 2011:



At December 31, 2011, the Company was party to the following agreements with other members of its holding company system:

Master Transaction Agreement – 2009 MTA

Effective July 15, 2009, the Company, SGI and certain affiliates consummated a Master Transaction Agreement with certain of its financial counterparties to CDS contracts insured by its financial guaranty insurance policies and certain related transactions (collectively referred to as “the 2009 MTA”), which along with approval of the Department to apply certain accounting practices in connection with the preparation of SGI’s statutory financial statements for certain of the transactions comprising the 2009 MTA, resulted in SGI’s return to compliance with its regulatory minimum surplus to policyholders. This agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law.

Tax Sharing and Payment Agreement

Pursuant to a tax sharing and payment agreement, the Company files consolidated federal income tax returns with its indirect United States parent, Syncora Holdings US Inc. (“SHUSA”), and its affiliates. This agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law.

Escrow Agreement

Effective December 29, 2010, the Company and SHUSA entered into an Escrow agreement with the Bank of New York Mellon (“Escrow Agent”), whereby, SHUSA is required to establish and maintain a special account consisting of assets eligible as an investment for the Company under the New York Insurance Law in an amount equal to the excess of the amount paid by the Company to SHUSA for federal income taxes over the actual tax payment made by the parent.

Second Amended and Restated General Service Agreement

Effective July 15, 2009, the Company entered a second amended and restated general services agreement with Syncora Guarantee Services Inc (“SGSI”). Under the agreement, SGSI provided the Company office space and management services, including, but not limited to, surveys and

underwriting expenses; audit of insured's records; salaries and benefits; payroll taxes; employee health & welfare plans; pensions; travel and expenses; insurance; equipment; printing and stationary; postage; telephone and telegraph exchange and express; legal and auditing; surveillance and remediation; and other miscellaneous services. The general services agreement requires that expenses should be allocated in a fair, reasonable and consistent manner according to Department Regulation 30. This agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2011, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	28%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	82%
Premiums in course of collection to surplus as regards policyholders	2%

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 two and half year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$ 91,336,602	48.4%
Other underwriting expenses incurred	146,310,801	77.5
Net underwriting loss	<u>(48,798,065)</u>	<u>(25.8)</u>
Premiums earned	<u>\$188,849,338</u>	<u>100.0%</u>

F. Accounts and Records

I. Settlement of Intercompany Balances

The Company is a party to a General Service Agreement with its ultimate parent company, Syncora Holding Ltd ("SHL"). Under the terms of the agreement, a monthly report covering all items and incurred charges and/or credits should be furnished and the final payment remitted within

fifteen days upon receipt of such report. A review of the intercompany settlement revealed that the Company is not settling its balances according to the filed agreement.

It is recommended that the Company settle its intercompany balances within the timeframe specified in its filed intercompany agreement.

II Directors and Officers Insurance Policy

A reviewed of the Company's Directors and Officers insurance policy revealed that it does not contain the retention and coinsurance requirements as set forth in Parts 72.2 and 72.3 of Department Regulation 110.

It is recommended that the Company comply with Department Regulation 110 with regards to its Directors and Officers insurance policy.

III Surplus Notes

The Company issued \$200,000,000 long-term surplus notes and \$150,000,000 short-term surplus notes with an annual interest rate of 6% and 5% respectively.

In 2010, the Company paid interest of \$11,700,000 and \$5,437,500 in its long and short-term surplus notes, respectively, and was given approval to repay \$75 million on its \$150 million short-term surplus notes. In 2011 the Company paid interest of \$12,166,666 and \$3,802,084 on its long and short-term surplus notes, respectively. In addition, the Company repaid the remaining \$75 million principal outstanding on its short-term surplus notes.

These surplus notes were approved in accordance with Section 1307 of the New York Insurance Law on July 15, 2009.

IV Permitted Practices

The Department approved certain permitted practices to allow the Company among other things to reflect certain assets as admitted assets without giving effect to the limitations set forth in Articles 14 and 69 of the New York Insurance Law, to de-recognize contingency reserves on terminated policies, and policies on which the Company has established case reserves, to de-recognize reserves for unpaid losses, unearned premium reserve, and contingency reserves related to,

and expense payments made to effect certain transactions which the Company effectively defeased or, in-substance, commuted, in whole or in part, the policies thereto; to value the surplus notes issued by the Company in settlement of certain policy obligations in connection with 2009 MTA at face value.

The permitted practices were approved by the Department.

V Going Concern Issue

The Company's parent company has disclosed in its annual statement for the year ended December 31, 2011 that there is substantial doubt about its ability to continue as a going concern and it can not provide any assurance that the Department would not take regulatory action against it, which may include commencement of rehabilitation or liquidation proceedings. Although management believes the Company has the financial and operating ability to continue independently of Syncora Guarantee Inc., no assurance can be given that rehabilitation, liquidation, or other regulatory action against SGI would not adversely affect the Company or subject the Company to further regulatory oversight or intervention.

3. FINANCIAL STATEMENTS

A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2011 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Examination</u> <u>Assets Not</u> <u>Admitted</u>	<u>Net Admitted</u> <u>Assets</u>
Bonds	\$646,885,744	\$0	\$646,885,744
Preferred stocks (stocks)	5,591,349	0	5,591,349
Common stocks (stocks)	3,591,200	0	3,591,200
Cash, cash equivalents and short-term investments	47,001,168	0	47,001,168
Other invested assets	1,991,863	0	1,991,863
Investment income due and accrued	5,326,832	0	5,326,832
Uncollected premiums and agents' balances in the course of collection	2,871,481	0	2,871,481
Net deferred tax asset	1,284,479	0	1,284,479
Receivables from parent, subsidiaries and affiliates	1,563,090	0	1,563,090
Premium tax	42,289		42,289
Bank of NY/Mellon - Indemnification	<u>50,000</u>	<u>0</u>	<u>50,000</u>
Total assets	<u>\$716,199,495</u>	<u>\$0</u>	<u>\$716,199,495</u>

Liabilities, surplus and other funds

	<u>Examination</u>
Losses and loss adjustment expenses	\$ (334,917)
Reinsurance payable on paid losses and loss adjustment expenses	414,256
Loss adjustment expenses	3,354,531
Other expenses (excluding taxes, licenses and fees)	139,000
Taxes, licenses and fees (excluding federal and foreign income taxes)	166,066
Unearned premiums	346,102,710
Ceded reinsurance premiums payable (net of ceding commissions)	1,826
Payable to parent, subsidiaries and affiliates	9,347,895
Mandatory contingency reserve for adverse losses	<u>224,327,593</u>
Total liabilities	<u>\$583,518,960</u>
Common capital stock	\$2,500,000
Surplus notes	200,000,000
Gross paid in and contributed surplus	189,000,000
Unassigned funds (surplus)	<u>(258,819,465)</u>
Surplus as regards policyholders	<u>\$132,680,535</u>
Totals	<u>\$716,199,495</u>

Note: The Internal Revenue Service has completed its audits of the Company's ultimate parent's consolidated Federal Income Tax returns through tax year 2008. No material adjustments arose from said audits. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2009 and 2010. 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. Statement of Income

Surplus as regards policyholders decreased \$148,917,443 during the two and half-year examination period July 15, 2009 through December 31, 2011, detailed as follows:

Underwriting Income

Premiums earned		\$188,849,338
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Deductions:

Losses and loss adjustment expenses incurred	\$91,336,602	
Other underwriting expenses incurred	72,245,594	
Aggregate write-ins for underwriting deductions	<u>34,207</u>	

Total underwriting deductions		<u>163,616,403</u>
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Net underwriting gain or (loss)		\$ 25,232,935
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Investment Income

Net investment income earned	\$14,010,651	
Net realized capital gain	<u>20,836,105</u>	

Net investment gain or (loss)		34,846,756
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Other Income

Forbearance fee and other income	\$ <u>9,097,881</u>	
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Total other income		<u>9,097,881</u>
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Net income after dividends to policyholders but before federal and foreign income taxes		\$ 69,177,572
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Federal and foreign income taxes incurred		<u>32,410,880</u>
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Net Income		\$ <u>36,766,692</u>
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	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Surplus as regards policyholders per report on organization as of July 15, 2009			\$281,597,977
Net income	\$36,766,692	\$ 0	
Net unrealized capital gains or (losses)	91,636		
Change in net deferred income tax	1,333,822		
Change in surplus notes		150,000,000	
Mandatory contingency reserves for adverse losses	<u>0</u>	<u>37,109,593</u>	
Net increase (decrease) in surplus	<u>\$38,192,150</u>	<u>\$187,109,593</u>	<u>\$(148,917,443)</u>
Surplus as regards policyholders per report on examination as of December 31, 2011			<u>\$132,680,534</u>

4. LOSSES AND CONTINGENCY RESERVES

The examination liabilities for losses and contingency reserves are \$(334,917) and \$224,327,593, respectively, as of December 31, 2011. These are the same as the amounts reported by the Company in its 2011 filed annual statement.

Losses are attributable to a previously unanticipated full reimbursement of a public finance claim. In addition to case reserves, the Company is required to establish and maintain contingency reserves for the protection of insureds and claimants against the effect of excessive losses occurring during adverse economic cycles. The amount required for these reserves depends on the type of bonds being insured and are established pursuant to the provisions of Section 6903(a) of the New York Insurance Law.

A review of the Company's case reserve losses methodology, surveillance and modeling was conducted by the Markets Division. This review included all structured products and selected public finance obligations with losses or high risk of losses.

The Company's estimate of reserves for losses on its exposures is based on certain assumptions. Changes in such assumptions could materially adversely affect such reserve estimates, including those as a result of more adverse macroeconomic conditions, the bankruptcies of issuers of bonds insured or swap counterparties, and the amount and timing of any claims. Under certain conditions, many of which are event-driven and outside the control of the Company; these exposures may result in significant increases in claims beyond that assumed in the Company's reserve estimates (that may or may not result in an increase in such loss reserves) against the Company. In addition, the value of its investment portfolio could change and have material adverse affect.

5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

This is the first report since the report on organization in 2009; therefore, there is no prior report on examination recommendations.

6. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>		<u>PAGE NO.</u>
A	<u>Reinsurance</u> It is recommended that the Company file the reinsurance attestation as indicated in the Annual Statement Instructions.	7
B	<u>Accounts and Records</u>	
i	It is recommended that the Company settle its intercompany balances within the timeframe specified in its filed intercompany agreement.	11
ii	It is recommended that the Company comply with Department Regulation 110 with regards to its Directors and Officers insurance policy.	11

APPOINTMENT NO. 30765

NEW YORK STATE

DEPARTMENT OF FINANCIAL SERVICES

I, **BENJAMIN M. LAWSKY**, Superintendent of Financial Services of the State of New York, pursuant to the provisions of the Financial Services Law and the Insurance Law, do hereby appoint:

Maribel Nunez

as a proper person to examine the affairs of the

SYNCORA CAPITAL ASSURANCE, INC.

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

CORPORATION

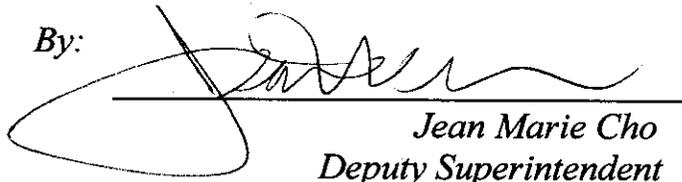
with such other information as she shall deem requisite.

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

this 2nd day of December, 2011

BENJAMIN M. LAWSKY
Superintendent of Financial Services

By:


Jean Marie Cho
Deputy Superintendent

