

REPORT ON EXAMINATION

OF

SYNCORA CAPITAL ASSURANCE INC.

AS OF

DECEMBER 31, 2016

DATE OF REPORT

MARCH 5, 2018

EXAMINER

KEVIN MCNAMEE

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NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Maria T. Vullo
Superintendent

March 5, 2018

Honorable Maria T. Vullo
Superintendent
New York State Department of Financial Services
Albany, New York 12257

Madam:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 31649 dated July 19, 2017 attached hereto, I have made an examination into the condition and affairs of Syncora Capital Assurance Inc. as of December 31, 2016, 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 examination of the Company, a multi-state insurer. The previous examination was conducted as of December 31, 2011. This examination covered the five-year period from January 1, 2012 through December 31, 2016. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner. This examination was performed in conjunction with the examination of Syncora Guarantee Inc., the Company's parent.

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 current and 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. This 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 New York Laws, statutory accounting principles, and annual statement instructions.

This examination report includes, but is not limited to, the following:

- Company history
- Management and control
- Territory and plan of operation
- Holding company description
- Reinsurance
- Loss review and analysis
- Financial statement presentation
- Significant subsequent events
- Summary of recommendations

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 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. (“SCAI”) was incorporated under the laws of the State of New York on April 1, 2009 as a wholly-owned subsidiary of Syncora Guarantee Inc. (“SGI”), a New York domiciled financial guaranty insurance company, which is ultimately controlled by Syncora Holdings Ltd., a Bermuda based holding company. The Company commenced business on July 15, 2009.

A. Corporate Governance

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 seven nor more than nineteen members. The board meets four times during each calendar year. At December 31, 2016, the board of directors was comprised of the following nine members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Susan Comparato * Glen Ridge, NJ	President and Chief Executive Officer, Syncora Guarantee Inc.
Michael Patrick Esposito Jr. Longboat Key, FL	Chairman, Syncora Guarantee Inc.
Edmund Graham Gibbons Hamilton Parish HS02, Bermuda	Member of Parliament, Bermuda
Robert Martin Lichten Jupiter, FL	Co-Chairman, Inter-Atlantic Securities Corporation
Thomas Stanley Norsworthy Bethel, CT	President and Chief Financial Officer, Aylesbury Insurance Acquisitions, Inc.
Frank Charles Puleo Park City, UT	Director, Various corporations
Coleman DeVane Ross Chapel Hill, NC	Director, Pan-American Insurance Group
Robert Sterling Strong Greenwich, CT	Director, Various corporations
Robert Joel White Los Angeles, CA	Director, Various corporations

Section 312(b) of the New York Insurance Law, states, in part:

“A copy of the report shall be furnished by such insurer or other person to each member of its board of directors and each such member shall sign a statement which shall be retained in the insurer's files confirming that such member has received and read such report...”

Although the Company provided the prior Report on Examination to its board of directors, the Company could not provide a statement signed by each director confirming that they have received and read the prior Report on Examination. It is recommended that the Company retain signed statements from each member of its board of directors confirming that each member has received and read the Report on Examination in accordance with Section 312(b) of the New York Insurance Law.

As of December 31, 2016, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Susan Comparato *	President and Chief Executive Officer
Frederick Barton Hnat	Chief Operating Officer
David Michael Grande	Chief Financial Officer

* Susan Comparato resigned as of May 31, 2017.

B. Territory and Plan of Operation

As of December 31, 2016, the Company was licensed to write business in the state of New York only and was licensed as an accredited reinsurer in Kentucky, Idaho and Michigan. The sole purpose for the formation of the Company was to (i) reinsure certain of SGI's public finance business and certain of its global infrastructure business pursuant to a quota share reinsurance agreement, and (ii) to assume through novation, certain guarantees written by non-public finance debt obligations and obligations of certain of SGI's insurance policies covering affiliates under credit default swap (“CDS”) contracts.

The Company is prohibited from writing new business per the terms of a master transaction agreement (“MTA”), effective July 15, 2009 with SGI. The MTA was established to remediate

SGI's reported policyholder deficit and reestablish compliance with the regulatory minimum policyholder surplus. The MTA provided for the business assumed through reinsurance and novation as indicated above. This agreement was non-disapproved by the Department pursuant to Section 1505 of the New York Insurance Law.

On August 12, 2016, Syncora Holdings US Inc., a wholly-owned subsidiary of Syncora Holdings Ltd. ("SHL"), completed a surplus note exchange offer and proxy solicitation with SGI for the variation of rights to the SHL Preferred Shares, which are part of its restructuring transactions. Upon closing of the transactions (collectively "Restructuring Transactions"), the Company increased its unassigned surplus to the greatest extent possible given its current gross paid in and contributed surplus by allocating the entire balance of that account to unassigned surplus. The Restructuring Transactions were approved by the Department on August 5, 2016.

Gross paid in and contributed surplus changed as follows during the examination period:

<u>Year</u>	<u>Description</u>	<u>Amount</u>
1/1/2012	Beginning gross paid in and contributed surplus	\$ 0
2014	Capital Contribution from SGI*	\$ 30,000,000
2016	Reclassified to unassigned funds	<u>\$(30,000,000)</u>
12/31/2016	Ending gross paid in and contributed surplus	<u>\$ 0</u>

*On November 13, 2014 SGI made a one-time capital contribution of \$30 million to the Company which increased its surplus by the same amount. This capital contribution was approved by the Department.

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)	Surety
25	Financial guaranty

Based upon the lines of business for which the Company is licensed, 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 million.

The following schedule shows the direct and assumed premiums written by the Company for the period under examination:

<u>Calendar Year</u>	<u>Direct Premiums</u>	<u>Assumed Premiums</u>	<u>Total Gross Premiums</u>
2012	\$20,665,201	\$11,290,974	\$31,956,175
2013	\$16,186,254	\$ 6,158,645	\$22,344,899
2014	\$ 9,336,524	\$ 6,070,488	\$15,407,012
2015	\$ 5,763,782	\$ 6,037,166	\$11,800,948
2016	\$ 4,464,041	\$ 5,556,541	\$10,020,582

The premiums included in the table above reflect installment premiums on existing run-off business assumed from SGI.

C. Reinsurance Ceded

The Company's ceded reinsurance program consists of one master facultative reinsurance agreement with Assured Guaranty Re International Ltd., an unauthorized reinsurer, whereby the Company ceded 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.

It is the Company's policy to obtain the appropriate collateral for its cessions to unauthorized reinsurers. A trust account obtained by the Company to take credit for cessions to unauthorized reinsurers was reviewed for compliance with Department Regulation 114. No exceptions were noted.

The ceded reinsurance agreement in effect as of the examination date was 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 found that the Schedule F data reported by the Company in its filed annual statement accurately reflected its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing

risk as set forth in SSAP No. 62R. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's Chief Executive Officer and Chief Financial Officer pursuant to the NAIC Annual Statement Instructions. 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. 62R.

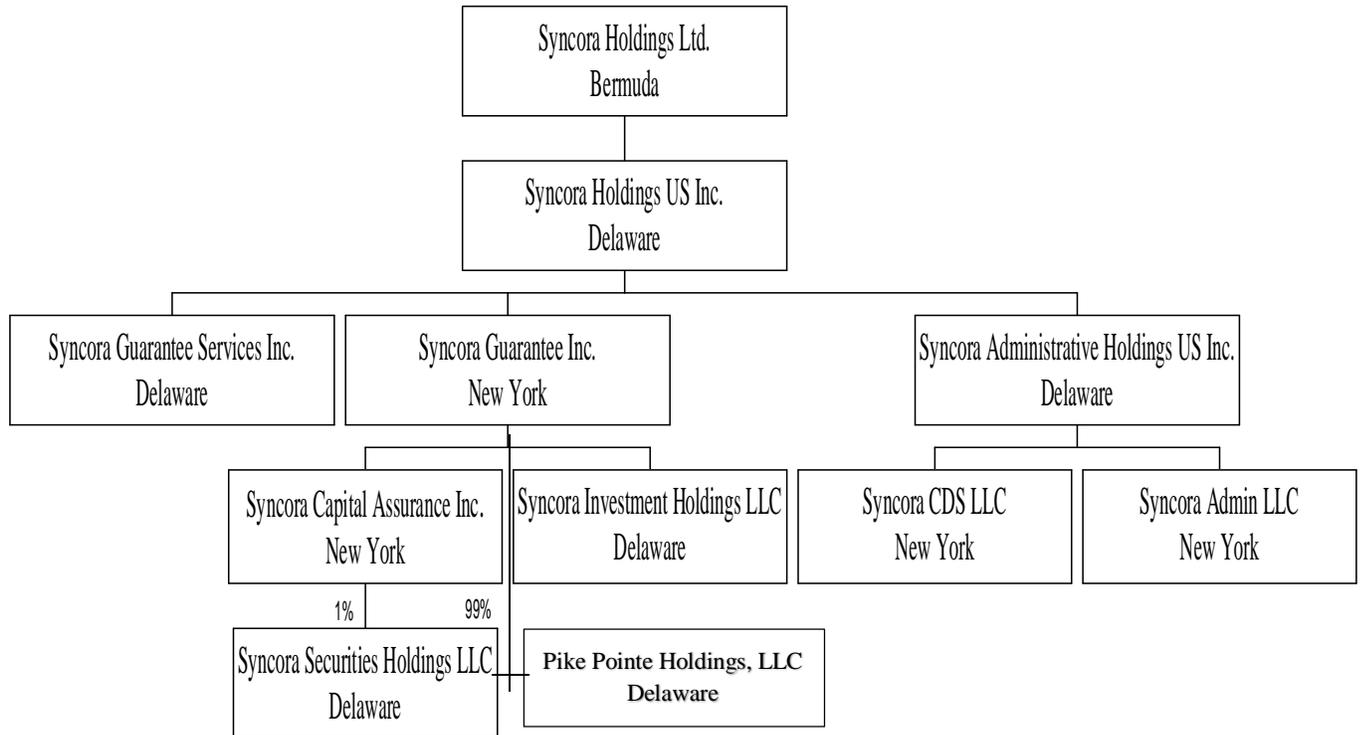
D. Holding Company System

The Company is a member of Syncora Holdings Ltd., a Bermuda based holding company. The Company is a wholly-owned subsidiary of SGI, a New York domiciled financial guaranty insurance company, which is ultimately controlled by Syncora Holdings Ltd, the ultimate parent.

The Company owns 1% of Syncora Securities Holdings LLC (“SSHL”), a non-insurance 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 an abridged chart of the holding company system at December 31, 2016:



Holding Company Agreements

At December 31, 2016, the Company was party to the following agreements with other members of its holding company system:

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, 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. Subsequent to this examination, this agreement was amended on June 1, 2018 to provide for quarterly (rather than monthly) reporting and payment for specified services and such amendment was approved by the Department on June 1, 2018.

Tax Sharing and Payment Agreement

Pursuant to a tax sharing and payment agreement, the Company files consolidated federal income tax returns with Syncora Holdings US Inc. and various affiliates. This agreement was submitted to the Department pursuant to the provisions of Department Circular Letter 33 (1979).

E. Accounts and Records

Settlement of Intercompany Balances

As noted above, the Company is a party to a general service agreement with SGSI. 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 comply with the settlement terms of its intercompany service agreement.

Subsequent to this examination, this agreement was amended on June 1, 2018 and the amendment was approved by the Department on June 1, 2018. The amendment changes the reporting requirement of specified services and the allocation of specified expense to be done quarterly rather than monthly.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2016 as reported by the Company:

<u>Assets</u>	Net Admitted <u>Assets</u>
Bonds	\$338,364,946
Preferred stocks	2,582,000
Common stocks	24,445,654
Cash, cash equivalents and short-term investments	51,343,052
Other invested assets	3,923,770
Investment income due and accrued	3,742,668
Uncollected premiums and agents' balances in the course of collection	1,014,300
Net deferred tax asset	1,259,098
Receivables from parent, subsidiaries and affiliates	296,614
Account receivable	210,270
Bank of NY/Mellon indemnification	<u>50,000</u>
Total assets	<u>\$427,232,372</u>

Liabilities, Surplus and Other FundsLiabilities

Losses and loss adjustment expenses	\$ 57,547,018
Reinsurance payable on paid losses and loss adjustment expenses	96,188
Other expenses (excluding taxes, licenses and fees)	4,000
Taxes, licenses and fees (excluding federal and foreign income taxes)	152,855
Unearned premiums	121,567,430
Ceded reinsurance premiums payable (net of ceding commissions)	1,754
Payable to parent, subsidiaries and affiliates	8,680,808
Mandatory contingency reserve for adverse losses	<u>13,424,229</u>
 Total liabilities	 \$201,474,282

Surplus and other funds

Common capital stock	\$ 2,500,000	
Surplus notes	200,000,000	
Unassigned funds (surplus)	<u>23,258,090</u>	
Surplus as regards policyholders		<u>225,758,090</u>
 Total liabilities, surplus and other funds		 <u>\$427,232,372</u>

Note: The Internal Revenue Service has completed its audits of the Company's consolidated Federal Income Tax returns through tax year 2008. 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. There are no audits currently under examination. 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

The net loss for the examination period as reported by the Company was \$151,956,044 as detailed below:

Underwriting Income

Premiums earned		\$ 315,189,105
Deductions:		
Losses and loss adjustment expenses incurred	\$297,333,517	
Other underwriting expenses incurred	<u>111,280,132</u>	
Total underwriting deductions		<u>408,613,649</u>
Net underwriting gain or (loss)		\$ (93,424,544)

Investment Income

Net investment income earned	\$ 49,582,324	
Net realized capital gain	<u>(135,260,794)</u>	
Net investment gain or (loss)		(85,678,470)

Other Income

Waiver and forbearance fees*	\$ <u>24,882,192</u>	
Total other income		<u>24,882,192</u>
Net income before federal and foreign income taxes		\$(154,220,822)
Federal and foreign income taxes incurred		<u>(2,264,778)</u>
Net loss		<u>\$(151,956,044)</u>

*Incurred when the insured party wants to make a change or has made a non-material breach to the covenants in a contract and wants a waiver to confirm they are not in default of the covenants. In some cases, legal fees are also covered.

C. Capital and Surplus

Surplus as regards policyholders increased \$93,077,555 during the five-year examination period January 1, 2012 through December 31, 2016 as reported by the Company, detailed as follows:

Surplus as regards policyholders per report on examination as of December 31, 2011			\$132,680,535
	<u>Gains in</u>	<u>Losses in</u>	
	<u>Surplus</u>	<u>Surplus</u>	
Net income/loss	\$ 0	\$151,956,044	
Net unrealized capital gains or (losses)	2,701,147		
Change in net deferred income tax	212,321		
Cumulative effect of changes in accounting principles	1,216,767		
Mandatory contingency reserves for adverse losses	210,903,364		
Capital contribution	<u>30,000,000</u>	<u>0</u>	
Total gains and losses	\$245,033,599	\$151,956,044	
Net increase (decrease) in surplus			<u>93,077,555</u>
Surplus as regards policyholders per report on examination as of December 31, 2016			<u>\$225,758,090</u>

No adjustments were made to surplus as a result of this examination.

As of December 31, 2016, capital paid in was \$2,500,000 consisting of 2,500 shares of \$1,000 par value per share common stock.

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$57,547,018 is the same as reported by the Company as of December 31, 2016. The examination analysis of the Loss and loss adjustment expense reserves was conducted in accordance with generally accepted actuarial principles and statutory accounting principles, including the NAIC Accounting Practices & Procedures Manual, Statement of Statutory Accounting Principle No. 60 (“SSAP No. 60”). The Department found the case reserves to be adequate.

The Department utilized the assistance of an independent financial advisory firm that specializes in complex assets to review the adequacy of the Company’s modeling, assumptions, and surveillance policies and procedures as of December 31, 2016. The firm reviewed all obligors insured by SCAI with emphasis on those public finance obligors for which the Company had case reserves or deemed that the obligor required further scrutiny. SCAI’s underwriting, surveillance, modeling and modelling assumptions are adequate.

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). In addition, the value of its investment portfolio could change and have material adverse effect.

5. MANDATORY CONTINGENCY RESERVE

Pursuant to Section 6903(a) of the New York Insurance Law, the Company is required to establish and maintain contingency reserves for the protection of policyholders and claimants against the effect of excessive losses occurring during adverse economic cycles. As of the December 31, 2016, the Company reported a contingency reserve of \$13,424,229.

6. UNEARNED PREMIUM RESERVE

The Company maintains an unearned premium reserve in accordance with Section 6903(c) of the New York Insurance Law. Unearned premiums represent the portion of premiums which are applicable to the unexpired risk on policies in force. As of December 31, 2016, the Company reported an unearned premium reserve of \$121,567,430.

7. SUBSEQUENT EVENTS

On July 12, 2017, SGI requested, and subsequently received, permission from the Department to merge with the Company, citing changing economic conditions and the run-off status of both companies. On December 31, 2017, SGI completed its merger with the Company, with SGI being the surviving entity.

8. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>		<u>PAGE NO.</u>
	<u>Reinsurance</u>	
A.	It was recommended that the Company file the reinsurance attestation as indicated in the Annual Statement Instructions.	7
	The Company has complied with this recommendation.	
	<u>Accounts and Records</u>	
B.	It was recommended that the Company settle its intercompany balances within the timeframe specified in its filed intercompany agreement.	11
	The Company has not complied with this recommendation. A similar recommendation has been included in this report.	
C.		11

9. SUMMARY OF COMMENTS AND RECOMMENDATIONS

<u>ITEM</u>		<u>PAGE NO.</u>
A.	<u>Corporate Governance</u> Although the Company provided the prior Report on Examination to its board of directors, it is recommended that the Company retain signed statements from each member of its board of directors confirming that each member has received and read the Report on Examination in accordance with Section 312(b) of the New York Insurance Law.	4
B.	<u>Accounts and Records</u>	
ii.	It is recommended that the Company comply with the settlement terms of its intercompany service agreement.	9

Respectfully submitted,

Kevin McNamee
Associate Insurance Examiner

STATE OF NEW YORK)
)ss:
COUNTY OF NEW YORK)

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

Kevin McNamee

Subscribed and sworn to before me
this _____ day of _____, 2018.

NEW YORK STATE

DEPARTMENT OF FINANCIAL SERVICES

I, Maria T. Vullo, 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:

Kevin McNamee

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

COMPANY

with such other information as he shall deem requisite.

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

this 19th day of July, 2017

MARIA T. VULLO
Superintendent of Financial Services



By: Joan P. Riddell

Joan Riddell
Deputy Bureau Chief