

REPORT ON EXAMINATION

OF

EPSILON (US) INSURANCE COMPANY

AS OF

DECEMBER 31, 2015

DATE OF REPORT

SEPTEMBER 30, 2016

EXAMINER

WEI CAO

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NEW YORK STATE  
DEPARTMENT *of*  
FINANCIAL SERVICES

Andrew M. Cuomo  
Governor

Maria T. Vullo  
Superintendent

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

September 30, 2016

Madam:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 31496 dated June 14, 2016, attached hereto, I have made an examination into the condition and affairs of Epsilon (US) Insurance Company as of December 31, 2015, and submit the following report thereon.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate Epsilon (US) Insurance Company. Wherever the designation "MMC" appears herein without qualification, it should be understood to indicate Marsh & McLennan Companies, Inc., the ultimate parent of Epsilon (US) Insurance Company.

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

## **1. SCOPE OF EXAMINATION**

The examination covers the period from the commencement of operations by the Company on June 25, 2010 through December 31, 2015 and was limited in its scope to a review or audit of only those balance sheet items considered by this Department to require analysis or verification. Transactions occurring subsequent to this period were reviewed where deemed appropriate. The examination included a review of Company records deemed necessary to accomplish such analysis or verification. Additionally, a review was performed to determine whether the captive insurer was operating within its by-laws, conforming with its plan of operation as submitted to the New York State Department of Financial Services, and was in compliance with Article 70 of the New York Insurance Law (the Law).

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 Law.

The report utilized work performed by the Company's independent certified public accountant and its opining actuary to the extent considered appropriate.

## **2. DESCRIPTION OF COMPANY**

The Company was incorporated under the laws of New York State as a captive insurance company on June 14, 2010. The Company is a wholly-owned subsidiary of MMC. On September 30, 2010, the Company was capitalized with five million dollars contributed by MMC. In 2011, MMC contributed an additional three million dollars to the paid-in capital of the Company.

Marsh & McLennan Companies, Inc. is a global professional services firm offering clients advice and solutions in risk, strategy and people. MMC's four operating companies are: Marsh, a leader in insurance brokering and risk management; Guy Carpenter, a leader in reinsurance and intermediary advisory services; Mercer, a leader in talent, health, retirement and investment consulting; and Oliver Wyman, a leader in management, economic and brand strategy consulting.

A. Articles of Incorporation

The Company is organized to transact the kinds of insurance specified in Section 1113(a) of the Law, subject at all times to the limitations on the business of pure captive insurance companies set forth in Article 70 of the Law.

B. By-Laws

The examination found that the Company was in compliance with its by-laws in all material respects.

C. Capital Structure

As a pure captive insurance company incorporated as a stock insurer, the Company is required to maintain a total surplus as regards policyholders of not less than \$250,000, of which \$100,000 shall represent paid-in capital pursuant to the provisions of Section 7004(a)(1) of the Law.

As of December 31, 2015, the Company's total paid-in capital was \$8,000,000, consisting of 100,000 shares of common stock with a par value of \$1 per share and an additional paid-in-capital amount of \$7,900,000. The Company had accumulated earnings of \$51,295,768, for a total capital and surplus of \$59,295,768.

D. Corporate Records

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

E. Operations

The Company provides MMC with professional liability insurance coverage on a claims-made basis. The professional liability policy had a limit of \$50,000,000 per claim with a \$5,000,000 per claim deductible.

As of December 31, 2015, The Company also provided excess errors and omissions coverage to MMC. The excess errors and omissions coverage was 100% reinsured by non-affiliated parties. The Company has structured its ceded reinsurance program as follows:

<u>Coverage</u>	<u>Policy limits</u>	<u>Reinsurers</u>
Excess errors and omissions	\$2.5M part of \$16M in excess of \$139M in excess of \$100M (SIR) each claim/aggregate	PZU Group (100%)
Excess errors and omissions	\$5M part of \$16M in excess of \$139M in excess of \$100M (SIR) each claim/aggregate	Catlin Underwriting, Inc. (40%) Transatlantic Reinsurance Company (20%) Berkley Insurance Company (40%)
Excess errors and omissions	\$1M part of \$30.75M in excess of \$155M in excess of \$100M (SIR) each claim/aggregate	Transatlantic Reinsurance Company (100%)

### Terrorism Risk Insurance Program Reauthorization Act of 2015 (TRIPRA 2015)

Effective May 31, 2015, the Company provided coverage for certified acts of Nuclear, Biological, Chemical or Radiological (NBCR) terrorism to MMC. The coverage's limit of liability was \$500,000,000 per occurrence. Certified acts of terrorism covered under this policy are defined in the Terrorism Risk Insurance Act (TRIA), which was enacted in 2002 and extended/reauthorized in 2005, 2007 and 2015. TRIA allows for the insurance industry and the federal government to share losses once a certified act of terror has been established, the program has been triggered and a statutorily established deductible has been absorbed by the insurer. The insurer retains 15% of the terrorism loss while the federal government would reimburse it for the remaining 85%.

In January 2015, TRIPRA 2015, which maintained the basic framework of TRIA, was extended through December 31, 2020. Starting January 1, 2016, the insurer's retention gradually increases each year from 15% to 20%. Additionally, the program's trigger of \$100 million in 2015 will increase gradually to \$200 million in 2020.

#### F. Management and Control

##### (i) Captive Manager

Section 7003(b)(4) of the Law provides that no captive insurer shall do any captive insurance business in this State unless it utilizes a captive manager resident in this State that is licensed as an agent or broker under the provisions of Article 21 of the Law, or any other person approved by the Superintendent.

During the period covered by this examination, the Company was managed by Marsh Management Services Inc., which is authorized to act as a manager for captive insurance companies by the Department.

Pursuant to a management agreement, effective June 25, 2010, Marsh Management Services has the responsibility for providing the Company with underwriting, policyholder services, claims, and other general management and operational services for a fee. These responsibilities include assisting the Company in complying with New York rules, regulations and requirements of the Law. The manager also aids in maintaining true and complete books of account and records of all business conducted under this agreement.

The agreement was amended on October 9, 2013, October 22, 2014 and on September 10, 2015, to reflect an updated annual fee.

(ii) Board of Directors

Pursuant to the Company's by-laws, management of the Company is vested in a board of directors consisting of not less than three nor more than ten members, at least two of whom shall be residents of New York State. At December 31, 2015, the board of directors was comprised of the following four members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Joel R. Hughes Northport, NY	Risk Manager Financial & Professional Lines, Marsh & McLennan Companies, Inc.
Karen A. Farrell New York, NY	Assistant Treasurer, Marsh & McLennan Companies, Inc.
James M. Mench Westfield, NJ	Assistant Controller, Marsh & McLennan Companies, Inc.
Nisala M. Weerasooriya Lake Grove, NY	Senior Vice President, Marsh Captive Solutions

In accordance with its by-laws and Section 7003(b)(2) of the Law, the board of directors must hold at least one meeting each year. A review indicated that the meetings were well attended.

(iii) Officers

As of December 31, 2015, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Joel R. Hughes	President
Karen A. Farrell	Vice President and Treasurer
James Mench	Vice President - Finance
Nisala M. Weerasooriya	Secretary
Jennifer R. Feldheim	Assistant Secretary

G. Certified Public Accountant (öCPAö)

Deloitte & Touche LLP was the Company's independent certified public accounting firm for the entire period covered by this examination. The CPA stated that the audited financial statement presented fairly, in all material respects, the Company's financial position as of December 31, 2015.

### 3. FINANCIAL STATEMENTS

The financial statements of the Company have been prepared in conformity with accounting principles generally accepted in the United States of America.

#### A. Balance Sheet

##### Assets

Cash	\$385,001	
Receivable from affiliate	116,411,492	
Premium receivable from affiliate	10,041,168	
Prepaid reinsurance premiums	167,335	
Prepaid expenses	16,875	
Deferred acquisition costs	60,941	
Federal income taxes receivable	197,489	
Reinsurance recoverable	<u>277,784</u>	
Total assets		<u>\$127,558,085</u>

##### Liabilities

Losses and loss adjustment expenses	\$56,933,440	
Unearned premium	11,160,847	
Ceded premiums payable	114,750	
Accounts payable and accrued expenses	<u>53,280</u>	
Total liabilities		\$68,262,317

##### Capital and Surplus

Common stock	\$100,000	
Additional paid-in capital	7,900,000	
Surplus (accumulated earnings)	<u>51,295,768</u>	
Total capital and surplus		<u>\$59,295,768</u>
Total liabilities, capital and surplus		<u>\$127,558,085</u>

B. Statement of Income

The Company's net income for the examination period was \$51,295,768 as detailed below:

STATEMENT OF INCOMEUnderwriting Income

Net premiums earned		\$108,693,265
Deductions:		
Loss and loss adjustment expenses incurred	\$56,929,215	
General and administrative expenses	570,763	
Policy acquisition expenses	<u>593,960</u>	
Total underwriting deductions		<u>58,093,938</u>
Net underwriting gain or (loss)		\$ 50,599,327

Investment Income

Net investment income	<u>444,300</u>	
Investment income		<u>444,300</u>
Net income before tax		\$51,043,627
Federal income tax benefit		<u>(252,141)</u>
Net income		<u>\$51,295,768</u>

C. Capital and Surplus Account

The Company's capital and surplus increased \$59,295,768 during the period covered by this examination, detailed as follows:

Capital and surplus as of June 25, 2010		\$0
	Increase in <u>surplus</u>	
Net income	\$51,295,768	
Issuance of common stock	100,000	
Additional paid in capital	<u>7,900,000</u>	
Net increase in surplus		<u>59,295,768</u>
Capital and surplus as of December 31, 2015		<u>\$59,295,768</u>

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

As of December 31, 2015, the Company reported total loss and loss adjustment expense reserves of \$56,933,440. The Company's opining actuarial firm, Oliver Wyman, noted in its Statement of Actuarial Opinion that the reserves met the requirements of the Law and had been evaluated in accordance with accepted loss reserving standards and practices. It also noted that reasonable provisions had been made for all unpaid losses and loss adjustment expenses under the terms of its policies and agreements.

5. ARTICLE 70 COMPLIANCE

Article 70 of the New York State Insurance Law is the governing section of the law for the formation and continued operation of captive insurers in New York State. A review was performed to test the Company's compliance with all applicable parts of Article 70. No significant areas of non-compliance were found.

**6. SUMMARY OF COMMENTS AND RECOMMENDATIONS**

There are no comments or recommendations in this report.

Respectfully submitted,

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Wei Cao  
Senior Insurance Examiner

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

WEI CAO, being duly sworn, deposes and says that the foregoing report, subscribed by her, is true to the best of her knowledge and belief.

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Wei Cao

Subscribed and sworn to before me

this \_\_\_\_\_ day of \_\_\_\_\_, 2016.

**APPOINTMENT NO. 31496**

**NEW YORK STATE**

**DEPARTMENT OF FINANCIAL SERVICES**

I, **Maria T. Vullo**, Acting 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:

**Wei Cao**

as a proper person to examine the affairs of the

**Epsilon (U.S.) Insurance Company**  
and to make a report to me in writing of the condition of said

**COMPANY**

with such other information as she 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 14th day of June, 2016

**MARIA T. VULLO**  
Acting Superintendent of Financial Services



By:

*Joan P. Riddell*

Joan Riddell  
Deputy Chief Insurance Examiner