

REPORT ON EXAMINATION

OF THE

BUILD AMERICA MUTUAL ASSURANCE COMPANY

AS OF

DECEMBER 31, 2013

DATE OF REPORT

December 23, 2014

EXAMINER

BERNARD LOTT

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NEW YORK STATE
DEPARTMENT *of*
FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Benjamin M. Lawskey
Superintendent

December 23, 2014

Honorable Benjamin M. Lawskey
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 31190 dated May 6, 2014, attached hereto, I have made an examination into the condition and affairs of Build America Mutual Assurance Company as of December 31, 2013, and submit the following report thereon.

Wherever the designations “the Company” or “BAM” appear herein without qualification, it should be understood to indicate Build America Mutual Assurance Company.

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 1 World Financial Center, 200 Liberty Street, New York, New York 10281.

1. **SCOPE OF EXAMINATION**

The Department has performed an individual examination of the Company, a multi-state insurer. This is the first financial examination of the Company after the examination on organization, which was conducted as of July 18, 2012. This examination covered the period from July 19, 2012 through December 31, 2013. Transactions occurring subsequent to this period were reviewed where deemed appropriate.

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. 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 Statutory Accounting Principles and annual statement instructions when applicable to domestic state regulations.

All financially significant accounts and activities of the Company were considered in accordance with the risk-focused examination process. The examiners also relied upon audit work performed by the Company’s independent public accountants when appropriate.

BAM is not a publicly traded company and is not required to comply with the provisions of the Sarbanes Oxley Act. The Company, however, voluntarily complies with Sarbanes Oxley based on its relationship with the White Mountains Insurance Group, Ltd. (“White Mountain”), which is a publicly traded company. White Mountain does not have an ownership interest in BAM but is the controlling parent of HG Global, Ltd. HG Global, Ltd. owns 100% of the companies that provided the initial funding for BAM through the purchase of surplus notes (See Item No. 2 in this report). White Mountain incorporates BAM’s financial results in its consolidated financial statements in accordance with generally accepted accounting principles.

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
- Growth of Company
- Loss experience
- Reinsurance
- Accounts and records
- Statutory deposits
- 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

Build America Mutual Assurance Company was incorporated under the laws of the State of New York on March 16, 2012 and the Department approved its Declaration of Intention and Charter on the same day. On July 17, 2012, the Company received its initial funding with the proceeds from the sale of Series 2012-A Surplus Notes and Series 2012-B Surplus Notes to HG Holdings Ltd. (“HG Holdings”), a Bermuda holding company and its wholly-owned subsidiary HG Re Ltd. (“HG Re”), in the amount of \$203,000,000 and \$300,000,000, respectively. Repayment of these notes by the Company, principal and/or interest, is subject to the prior approval of the Superintendent of the New York Department of Financial Services. BAM was licensed and commenced operations on July 20, 2012. The outstanding principal on the 2012-A surplus note must be repaid before any principal payments are paid on the 2012-B surplus note.

BAM was organized as a New York domiciled mutual financial guaranty insurance company and is owned by its members (the insured municipalities). Pursuant to the by-laws, a member's ownership/voter interest is determined by a formula which relates the principal amount of outstanding obligations of the member insured by the Company to the largest member principal amount insured.

Upon the issuance of a policy, members are required to contribute to BAM's surplus. These paid-in amounts are called member surplus contributions. As of the examination date, the Company's surplus as regards policyholders included \$17,333,374 in member surplus contributions.

The Company's By-Laws state that the corporation shall only issue non-assessable policies without the contingent mutual liability of the members for assessments.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a board of directors consisting of seven members. The board meets four times during each calendar year. At December 31, 2013, the board of directors was comprised of the following seven members:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Raymond Barrette Hanover, New Hampshire	Chairman and Chief Executive Officer, White Mountains Insurance Group, Ltd.
Robert Phillips Cochran New York, New York	Managing Director, Secretary and Chairman, Build America Mutual Assurance Company
Seán Wallace McCarthy New York, New York	Managing Director and Chief Executive Officer, Build America Mutual Assurance Company
Richard Ravitch New York, New York	Attorney, Businessman and Public Official
Edward Gene Rendell Philadelphia, Pennsylvania	Consultant, Edward Rendell LLC

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Robert Albert Vanosky Rancho Santa Fe, California	Retired
Allan Lewis Waters Hanover, New Hampshire	President and Chief Executive Officer, Sirius International Insurance Group, Ltd.

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, 2013, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Robert Phillips Cochran	Managing Director, Secretary and Chairman
Seán Wallace McCarthy	Managing Director and Chief Executive Officer
Alexander George Makowski, Jr.	General Counsel
Elizabeth Ann Keys	Chief Financial Officer and Treasurer

B. Territory and Plan of Operation

As of December 31, 2013, the Company was licensed to write business in all fifty states and the District of Columbia.

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, G, H and I)	Fidelity and Surety
25	Financial guaranty

Based on the lines of business for which the Company is licensed 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.

In 2013 the Company wrote a total of \$13,559,725 in direct premiums, of which \$3,047,278 or 22.47% was written for risks in New York State. Direct premiums written in calendar year 2012 totaled \$109,323, none of which was written in New York State.

BAM was established to provide bond insurance to the small and mid-sized municipal bond market and will focus on municipal bonds up to \$75 million. BAM's business plan provides that it will only insure investment grade bonds that are secured by general obligation, general fund obligation and first budget obligation pledges; dedicated tax revenues; or revenues of essential public services. BAM is a direct guarantor of principal and interest, when due, on debt obligations issued by state and local municipal governments and authorities located in the United States.

The Company places all of its business directly, without the use of agents or brokers. One state (Alabama) requires that a licensed agent countersign all policies written in that state.

C. Reinsurance

The Company does not assume any reinsurance. BAM's ceded reinsurance program consists of a single agreement, the First Loss Reinsurance Treaty Agreement ("Agreement"), with HG Re Ltd., an exempted Bermuda limited company.

Under the Agreement, effective July 20, 2012, HG Re agrees to indemnify the Company on any policy for an amount up to 15 percent of the principal amount or par value insured of the bonds, notes, obligations, or other instruments that are the subject of such policy. For the purposes of determining losses ceded under the Agreement, at the time the Company establishes a gross loss reserve with respect to any policy, the principal amount of the bonds, notes, obligations or other instruments insured under such policy shall be fixed as the principal amount at such time.

While the amount indemnified under the Agreement remains constant, the net premium ceded ranges from 77.9 percent for the first year of the policy to 63.2 percent with respect to the

sixth anniversary of the effective date through the remaining term of the agreement. The ceding commission allowed to the Company ranges from 23% of the net written premium paid in year-one to 5% of the net written premium paid with respect to the sixth anniversary of the effective date through the remaining term of the agreement.

The net cost of this reinsurance is 60% of the net written premium (defined in the Agreement as premiums collected by the Company, less cancellations, returns and premium that might be ceded to other reinsurers). The net cost number represents the difference between the amount of the net written premium ceded and the ceding commission allowed to the Company. The percentage of net premium ceded and the ceding commission allowed the Company varies with the treaty year, but the net difference between the two figures is always 60% of the net written premium.

The agreement provides for the cession of unearned premium reserves in proportion to the specified amount of net written premium ceded for the treaty year. Statutory contingency reserves are not ceded as part of this treaty. Loss reserves are ceded in accordance with the reinsurer's liability per the Agreement.

The Agreement is continuous in its term and remains in full force and effect, until it is terminated by mutual written consent of both BAM and HG Re. The terms and conditions of the Agreement may be renegotiated by either party on the tenth anniversary of its signing and each five-year anniversary thereafter.

HG Re, an unauthorized insurer, secures its obligations under the Agreement through two trust accounts: (i) the Regulation 114 Trust Account and (ii) the Supplemental Trust Account. The 114 Trust Account is funded with the 60% (net of ceding commission) of BAM's risk premium. The premium is accumulated and maintained in this account in order to collateralize its obligation, pursuant to the provision of the Agreement. The reinsurer's obligation represents its assumed unearned premium and loss reserves.

The Supplemental Trust was initially funded with \$100 million in cash and the \$300 million of BAM's Series B Surplus Notes mentioned in Item 2 of this report. At such time as the Department approves the principal payments on the BAM Series B Surplus Notes the proceeds will be retained in the Supplemental Trust Account until it reaches its target level of \$400 million. In summary, the supplemental trust fund at the examination date held approximately

\$100 million in liquid assets plus a non-liquid surplus note due from the Company which cannot be repaid without the approval of the Department.

The Agreement states that BAM may draw directly from either trust account to pay or reimburse itself for the payment of any loss, up to its 15% reinsurance coverage limit. Assets in both trusts are invested subject to the provisions of New York's Regulation 114. The Regulation 114 Trust was reviewed and approved by the Department as a condition of its initial licensing of the Company.

As of the examination date, the reinsurance agreement 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.

Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Management has represented that the ceded reinsurance agreement transferred both underwriting and timing risk as set forth in the Statements of Statutory Accounting Principles No. 62 ("SSAP No. 62") of the NAIC's Accounting Practices and Procedures Manual. Representations were supported by a risk transfer analysis and an attestation pursuant to the NAIC Annual Statement Instructions, signed by the Company's Chief Executive Officer and Chief Financial Officer. Additionally, the examination review indicated that the Company was not a party to any finite reinsurance agreements. The ceded reinsurance agreement was accounted for by utilizing reinsurance accounting as set forth in SSAP No. 62.

D. Holding Company System

BAM is organized in New York as a mutual insurer and as such is exempt from holding company matters and filings pursuant to Section 1502(a)1 of the New York Insurance Law. However, in light of the fact that BAM's business plan is strongly aligned and intertwined with that of HG Holdings and HG Re, it agrees to submit to this Department any agreements or amendments thereto, with HG Holdings and any of its affiliated entities.

White Mountains, a Bermuda domiciled financial services holding company, is the controlling parent of HG Global Ltd., a Bermuda corporation, which in turn owns 100% of both HG Holding and HG Re.

Effective October 1, 2013, the Company entered into a service agreement with HG Services Ltd. Under this agreement HG Services Ltd. provides analytical services as requested and directed by BAM. Services include, but are not be limited to, analyzing and reporting on primary issuance activity, trading activity, investor activity and competitive bond insurance activity within the municipal bond market. The agreement was submitted to and non-disapproved by the Department.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2013, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	0.6%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	3.6%
Premiums in course of collection to surplus as regards policyholders	0%

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 entire period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$ 0	N/A
Other underwriting expenses incurred	53,009,196	222,400%
Net underwriting loss	<u>(52,985,361)</u>	<u>(222,300)</u>
Premiums Earned	\$ <u>23,835</u>	<u>100%</u>

F. Accounts and Records

Section 4110(a) of the New York Insurance Law states, in pertinent part:

“No domestic mutual property/casualty insurance company licensed to write a kind of insurance specified in paragraph...sixteen ...of subsection (a) of section one thousand one hundred thirteen of this chapter shall expend in any one calendar year for management expenses a greater amount than thirty percent of the sum of its net premium income and seventy-five percent of its investment income for such year....”

The examination review found that the Company exceeded the management expense limit in 2012 and 2013. It is recommended that the Company comply with the management expense limitations set forth in Section 4110(a) of the New York Insurance Law.

G. Subsequent Events

On July 1, 2014 the Company formed a subsidiary, BAM Asset Management, LLC. BAM Asset Management, LLC is a limited liability company formed under the laws of Delaware. The subsidiary was created to administer a program to purchase uninsured municipal bonds in the secondary market that meet BAM’s insurance criteria, purchase insurance from BAM and then resell the newly insured bonds back in the secondary market. The subsidiary has been funded with \$5,001,000. As of the date of this report, the subsidiary has not commenced significant operations.

3. FINANCIAL STATEMENTS

A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2013 as determined by this examination and as reported by the Company:

<u>Assets</u>	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>
Bonds	\$450,017,589	\$0	\$450,017,589
Cash, cash equivalents and short-term investments	33,648,560	0	33,648,560
Investment income due and accrued	2,687,481	0	2,687,481
Electronic data processing equipment and software	1,579,187	1,552,714	26,473
Furniture and equipment, including health care delivery assets	247,743	247,743	0
Aggregate write-ins for other than invested assets	<u>1,097,269</u>	<u>948,494</u>	<u>148,775</u>
Totals	<u>\$489,277,829</u>	<u>\$2,748,951</u>	<u>\$486,528,878</u>

Liabilities, surplus and other fundsLiabilities

Losses and loss adjustment expenses	\$	0
Other expenses		11,183,984
Taxes, licenses and fees		227,934
Unearned premiums		2,997,024
Ceded reinsurance premiums payable		1,996,539
Contingency reserve		<u>1,074,002</u>
Total liabilities	\$	17,479,483

Surplus and Other funds

Member surplus contributions	\$	17,333,374
Surplus notes		503,000,000
Unassigned funds (surplus)		<u>(51,283,979)</u>
Surplus as regards policyholders		<u>\$469,049,395</u>
Total liabilities, surplus and other funds		<u>\$486,528,878</u>

Note:The Internal Revenue Service has not audited the Company's Federal Income Tax returns for the period covered by this 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 IncomeUnderwriting Income

Premiums earned		\$ 23,835
Deductions:		
Other underwriting expenses incurred	\$50,015,189	
Total underwriting deductions		<u>50,015,189</u>
Net underwriting gain or (loss)		\$(49,991,354)

Investment Income

Net investment income earned	\$ 6,483,310	
Net realized capital gain	<u>(958,975)</u>	
Net investment gain		<u>5,524,335</u>
Net income (loss) before federal income taxes		<u>\$(44,467,019)</u>

C. Capital and Surplus Account

Surplus as regards policyholders decreased \$30,956,598 during the examination period from July 20, 2012 through December 31, 2013, detailed as follows:

Surplus as regards policyholders per report on examination as of July 19, 2012			\$ 500,005,993
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net loss		\$44,467,019	
Change in nonadmitted assets		2,748,951	
Change in contingency reserves		1,074,002	
Member surplus contributions	<u>17,333,374</u>	<u>0</u>	
Net increase (decrease) in surplus	<u>\$17,333,374</u>	<u>\$48,289,972</u>	<u>\$ (30,956,598)</u>
Surplus as regards policyholders per report on examination as of December 31, 2013			<u>\$ 469,049,395</u>

4. **LOSSES AND LOSS ADJUSTMENT EXPENSES**

The examination liability for the captioned item of \$0 is the same as reported by the Company at December 31, 2013. For a financial guaranty insurer, this liability represents the case basis reserves established for insured transactions. BAM commenced business on July 20, 2012 and as of the examination date has yet to incur any loss or loss adjustment expenses.

The Department's Capital Markets Unit reviewed the Company's underwriting and surveillance processes and found them to be satisfactory. Furthermore, the Company's staff was found to demonstrate experience in the modeling of cash flows of municipal insurance should the need to model such losses arise.

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 examination date, the Company reported a contingency reserve of \$1,074,002.

In addition, 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, 2013, the Company reported an unearned premium reserve of \$2,997,024.

5. **SUMMARY OF COMMENTS AND RECOMMENDATIONS**

ITEM

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A Accounts and records

It is recommended that the Company comply with the management expense limitations set forth in Section 4110(a) of the New York Insurance Law.

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APPOINTMENT NO. 31190

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:

Bernard Lott

as a proper person to examine the affairs of the

Build America Mutual Assurance Company

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 6th day of May, 2014

*BENJAMIN M. LAWSKY
Superintendent of Financial Services*

By:



*Rolf Kaumann
Deputy Chief Examiner*

