

ASSOCIATION REPORT ON EXAMINATION  
OF THE  
LIBERTY INSURANCE UNDERWRITERS INC.  
AS OF  
DECEMBER 31, 2001

ZONES  
REPRESENTED

I  
II  
IV

STATES  
PARTICIPATING

NEW YORK  
MISSISSIPPI  
NEVADA

EXAMINERS

KENNETH MERRITT  
JOSEPH M. PIRES.CFE,CIE  
PIERRE J. GLOVER, CFE



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

Honorable Mike Pickens  
Chairman, Executive Committee  
Commissioner of Insurance  
State of Arkansas

June 4, 2003

Honorable Janie Miller  
Chairman, Southeastern Zone  
Commissioner of Insurance  
State of Kentucky

Honorable Gregory V. Serio  
Superintendent of Insurance  
State of New York

Honorable Mike Kreidler  
Chairman, Western Zone  
State of Washington

Sirs:

Pursuant to your instructions an examination has been made into the condition and affairs of the Liberty Insurance Underwriters Inc., hereinafter referred to as "the Company", at its administrative office located at 55 Water Street, New York, New York 10004.

The examination was conducted by the New York State Insurance Department, hereinafter referred to as "the Department" with participation from the State of Mississippi representing the Southeastern Zone and the State of Nevada representing the Western Zone.

The report on examination is respectfully submitted.

REPORT ON EXAMINATION  
OF THE  
LIBERTY INSURANCE UNDERWRITERS INC.  
AS OF  
DECEMBER 31, 2001

DATE OF REPORT

JUNE 4, 2003

EXAMINER

KENNETH MERRITT

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

George E. Pataki  
Governor

Gregory V. Serio  
Superintendent

June 4, 2003

Honorable Gregory V. Serio  
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 21832, dated January 30, 2002, attached hereto, I have made an examination into the condition and affairs of Liberty Insurance Underwriters Inc., as of December 31, 2001, and submit the following report thereon.

The examination was conducted at the Company's administrative office located at 55 Water Street New York, New York 10004.

Wherever the designation "the Company" appears herein without qualification, it should be understood to indicate Liberty Insurance Underwriters Inc.

Wherever the term "Department" appears herein without qualification, it should be understood to mean the New York Insurance Department.

## 1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1996. This examination covered the five-year period from January 1, 1997 through December 31, 2001. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

The examination comprised a complete verification of assets and liabilities as of December 31, 2001. The examination included a review of income, disbursements and Company records deemed necessary to accomplish such analysis or verification and utilized, to the extent considered appropriate, work performed by the Company's independent public accountants. A review or audit was also made of the following items as called for in the Examiners Handbook of the National Association of Insurance Commissioners:

- History of Company
- Management and control
- Corporate records
- Fidelity bond and other insurance
- Territory and plan of operation
- Growth of Company
- Business in force by states
- Reinsurance
- Accounts and records
- Financial statements
- Market conduct activities

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, which involve departures from laws, regulations or rules, or which are deemed to require explanation or description.

## **2. DESCRIPTION OF COMPANY**

The Company, formerly named Albany Insurance Company, is a domestic property and casualty insurer that was incorporated in the State of New York on March 8, 1811. The Company is a wholly owned subsidiary of Peerless Indemnity Company of Illinois (“Peerless”), and is ultimately controlled by Liberty Mutual Insurance Company (“Liberty Mutual”), a Massachusetts domiciled insurer. Prior to its 2002 re-domestication to the State of Illinois, Peerless was a New York domiciled property and casualty insurer that existed under the name, “Atlas Assurance Company of America”.

On May 10, 1999, Liberty Mutual a New York authorized insurer, acquired the Company and Peerless from Guardian Royal Exchange International (Holdings) BV (Netherlands). The transaction did not require a formal application filing for acquisition of control of insurers pursuant to Section 1506 of the New York Insurance Law.

The Company changed its name to Liberty Marine Underwriters Inc., effective on August 31, 1999, and adopted its current name effective November 30, 1999.

The Company has capital paid-in totaling \$3,500,000, consisting of 50,000 shares of common stock at \$70 par value per share. Gross paid in and contributed surplus is \$10,029,767, and has remained unchanged since the last examination of the Company.

Subsequent to the period covered by this report, the Company received surplus contributions totaling \$50,000,000.

A. Management

The Company's by-laws call for a board of directors consisting of at least thirteen but not more than twenty-one members. The following is a listing of the Company's thirteen board of directors at December 31, 2001:

<u>Name and Place of Residence</u>	<u>Business Affiliation</u>
Michael Abdullah Kenthurst, Australia	President, Liberty Insurance Underwriters Inc.
Anthony Carroll Yorktown Heights, NY	Senior Vice-President, Liberty Insurance Underwriters Inc.
J. Paul Condrin, III Walpole, MA	Senior Vice-President and Chief Financial Officer Liberty Mutual Insurance Company
Nick Creatura Toronto, ON	Executive Vice-President, Liberty International Underwriters
Daniel Forsythe Marblehead, MA	Executive Vice-President, Liberty Insurance Underwriters Inc.
James Kelleher Belmont, MA	General Counsel, Liberty International Underwriters
Dennis Langwell Franklin, MA	Vice-President and Controller, Liberty Mutual Insurance Company
Christopher Mansfield Dedham, MA	Vice-President and General Counsel, Liberty Mutual Insurance Company
Gordon McBurney Marblehead, MA	Chief Executive Officer, Liberty Insurance Underwriters Inc.
Joseph Morency Centerport, NY	Senior Vice-President, Liberty Insurance Underwriters Inc.
Frank O'Connor Mississauga, ON	Executive Vice- President, Liberty International Underwriters
Craig Pinnock Merrick, NY	Chief Financial Officer, Liberty Insurance Underwriters -USA
Thomas C. Ramey Cambridge, MA	Executive Vice-President, Liberty Mutual Insurance Company

The Company's board of directors amended its by-laws effective on June 29, 1999. At the time of the amendment, the Company violated Section 1201(a) of the New York Insurance Law by reducing the number of directors required to reside in the State of New York from three to two directors. However, it is noted that Section 1201(a) of the New York Insurance Law was amended in 2003 to require that only two directors reside in New York State.

Examination review revealed that the Company did not hold any board of directors' meetings during the period covered by this examination. In lieu of formal board meetings, the Company's business was conducted through "Action by Unanimous Consent of Directors without a Meeting".

The Company's by-laws require both regular meetings anytime as determined by resolution of the board and special meetings from time to time as called by the President or a Vice-President. It is recommended that the Company's board of directors meet at least once per year.

The examiner noted that the Company's board of directors did not approve any of the Company's investment transactions for the period covered by this examination. Section 1411 of the New York Insurance Law states, in, part as follows:

"No domestic insurer shall make any loan or investment...., unless authorized or approved by its board of directors or a committee thereof responsible for supervising or making such investment or loan. The committee's minutes shall be recorded and a report submitted to the board of directors at its next meeting".

It is recommended that the Company comply with Section 1411(a) of the New York Insurance Law and require board approval of all Company investment transactions. Such approval should be documented in the minutes of its board of directors' meetings.

As of December 31, 2001, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Michael Abdullah	President
A. Alexander Fontanes	Executive VP & Chief Investment Officer
Craig Pinnock	Executive Vice President
Dexter Legg	Secretary
Gordon McBurney	Chief Executive Officer
Craig Pinnock	Chief Financial Officer
Elliot Williams	Treasurer

B. Territory and Plan of Operation

The Company is licensed in all fifty states and the District of Columbia.

The Company was authorized to transact the kinds of business as defined in the following numbered paragraphs of Section 1113(a) of the New York Insurance Law as of the December 31, 2001 examination date:

<u>Paragraph</u>	<u>Line of Business</u>
3	Accident and health
4	Fire
5	Miscellaneous property damage
6	Water damage
7	Burglary and theft
8	Glass
9	Boiler and machinery
10	Elevator
11	Animal
12	Collision
13	Personal injury liability
14	Property damage liability
15	Workers' compensation and employers' liability
16	Fidelity and surety
19	Motor vehicle and aircraft
20	Marine and inland marine
21	Marine protection and indemnity

Under paragraphs 20 and 21 above, the Company is authorized to write such workers' compensation insurance coverage incidental therewith, including insurances described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803 69<sup>th</sup> Congress, as amended; 33 USC Section 901 et. seq. as amended).

Below is a summary of the Company's 2001 direct written premiums by States:

<u>State</u>	<u>Amount</u>	<u>Percentage of Total</u>
New York	\$ 22,440,962	20.9%
Texas	15,505,675	14.5
California	7,045,342	6.6
All other States	<u>62,154,828</u>	<u>58.0</u>
Totals	<u>\$ 107,146,807</u>	<u>100.0%</u>

The Company wrote primarily commercial multiple peril and ocean marine insurance, which comprised 48% and 24%, respectively, of its total gross written premiums in 2001. The Company ceded 100% of its gross writings. Cessions are first made to the Company's third party reinsurers, and the remaining cessions are made to Liberty Mutual pursuant to an inter-company quota share agreement between the Company and Liberty Mutual. This agreement is more fully discussed in Item 2C herein, "Reinsurance".

The following schedule shows the direct premiums written by the Company both in total and in New York for the period under examination:

DIRECT PREMIUMS WRITTEN

<u>Calendar</u> <u>Year</u>	<u>New York State</u>	<u>Total United States</u>	<u>Premiums Written in New York</u> <u>State as a</u> <u>Percentage of United States</u> <u>Premiums Written</u>
1997	\$19,295,979	\$ 82,021,794	23.53%
1998	\$16,022,650	\$ 82,577,139	19.40%
1999	\$14,453,434	\$ 81,178,254	17.80%
2000	\$18,700,425	\$ 70,685,287	26.46%
2001	\$22,440,962	\$107,146,807	20.94%

The Company wrote business under Liberty International Underwriters Inc. (“LIU”), a trade name for a Strategic Business Unit (“SBU”) of Liberty Mutual. LIU was formed in 1999 as Liberty Mutual’s global specialty lines unit, with an emphasis on niche insurance products distributed through an independent broker network. LIU serves both the United States and international (global) markets. LIU (United States) operates through the Company, Liberty Surplus Insurance Corporation (“LSIC”) and Liberty Mutual. LSIC is a New Hampshire domiciled insurer that operates as a surplus lines carrier in all fifty states. LIU (United States) operations are headquartered in New York with branch offices in several major cities throughout the United States. The main insurance lines marketed by the United States operations are ocean and inland marine, energy and engineering, specialty casualty and casualty.

Specialty casualty and casualty include: directors’ & officers’ liability, errors & omissions, environmental impairment liability, financial products, primary casualty and excess casualty.

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 and 41 of the New York Insurance Law, the Company is required to maintain a minimum surplus to policyholders in the amount of \$2,000,000.

A review of Schedule T and Schedule F-Part 1 of the Company's 2001 filed annual statement indicated that the Company insured and reinsured risks outside of the United States.

Section 4102(c) of the New York Insurance Law provides as follows:

"A property/casualty insurance company organized and licensed to write any basic kind of insurance, may be licensed, except with respect to the kinds of insurance defined respectively in the following paragraphs of subsection (a) of section one thousand one hundred thirteen of this chapter: life insurance (1), annuities (2) and title insurance (18), to (i) reinsure risks of every kind or description and (ii) insure property or risks of every kind or description located or resident outside of the United States, its territories and possessions".

Section 4103(a)(4) of the New York Insurance Law provides as follows:

"A stock property/casualty insurance company licensed under subsection (c) of section four thousand one hundred two of this article to reinsure risks or write insurance on risks outside the United States, its territories and possessions, must maintain a surplus to policyholders of at least thirty-five million dollars".

It appears that the Company is in violation of Sections 4102(c) and 4103(a)(4) of the New York Insurance Law by insuring and reinsuring risks outside of the United States without either the statutory authority or the required surplus to policyholders to do so. It is recommended that the Company cease and desist the transaction of insurance and reinsurance outside the United States in violation of Sections 4102(c) and 4103(a)(4) of the New York Insurance Law.

C. Reinsurance

Assumed

The Company reported a nominal amount of assumed reinsurance business for the 2001 calendar year. The Company indicated that the amount reflected as assumed business in Schedule F was actually direct business written outside of the United States. However, the examiner was unable to determine the

true nature of this assumed business since the Company could not produce any of the insurance contracts involved.

It is recommended that the Company report its direct and assumed premiums written in accordance with the annual statement instructions.

### Ceded

The following is a description of the Company's ceded reinsurance program in effect as of the examination date:

<u>Type of Treaty</u>	<u>Cession</u>
Marine Cargo Proportional Cargo Account Quota Share 100% Unauthorized	50% of \$10 million and/or equivalent in any other currencies any one declaration, any one vessel or bottom.
Cargo Surplus Share 100% Authorized	\$20 million surplus to \$10 million any one vessel or bottom.
Marine (all lines) Cargo Account Quota Share 100% Unauthorized	50% of \$10 million and/or equivalent in any other currencies any one declaration, any one vessel or bottom.
Property Per Risk Excess of Loss 100% authorized	100% of \$500,000 of ultimate net loss each risk up to \$4.5 million any one loss occurrence. \$13.5 million maximum limit for all risks per loss

occurrence.

Excess of Loss 23% authorized 77% unauthorized	32.5% of \$1 million excess of \$1 million per risk per occurrence.
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Type of Treaty

Cession

Marine Non-Proportional First Marine Excess of Loss 6% authorized 94% unauthorized	68.5% of \$4 million excess of \$2 million each and every loss, casualty or disaster.
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Second Marine Excess of Loss 11% authorized 89% unauthorized	90% of \$6 million excess of \$6 million each and every loss, casualty or disaster.
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Third Marine Excess of Loss 9% authorized 91% unauthorized	100% of \$8 million excess of \$12 million each and every loss, casualty or disaster.
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Fourth Marine Excess of Loss 1% authorized 99% unauthorized	100% of \$10 million excess of \$20 million each and every loss, casualty or disaster.
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Non marine (property, energy, engineering and course of construction) Quota Share 77% authorized 23% unauthorized	32.5% of \$100 million any one risk.
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Excess of Loss First Layer 100% Authorized	55% of \$2.5 million each and every loss excess of \$2.5 million each and every loss.
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Excess of Loss Second Layer 65% authorized 35% unauthorized	86% of \$5 million each and every loss excess of \$5 million each and every loss
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Excess of Loss Third Layer 57% authorized 43% unauthorized	100% of \$10 million each and every loss excess of \$10 million each and every loss.
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<u>Type of Treaty</u>	<u>Cession</u>
Excess of Loss Fourth Layer 92% authorized 8% unauthorized	66.25% of \$13.75 million each and every loss excess of \$20 million each and every loss.
Casualty Program	
Global Quota Share (Excess and Umbrella –U.S. business) Facultative 73% authorized 27% unauthorized	73.33% of 100% quota share of net liability in respect of an acceptance by the reinsured of up to \$30 million any one insured, each and every loss occurring and/or claim made and/or occurrence reported.
Global Quota Share (Excess and Umbrella -U.S. business) Facultative 73% authorized 27% unauthorized	76.5% of 100% quota share of net liability in respect of an acceptance by the reinsured of up to \$50 million any one insured, each and every loss occurring and/or claim made and/or occurrence reported.
Environmental Impairment Liability Quota Share 100% Authorized	75.9% of \$20.75 million gross liability subject to a maximum cession of \$15.75 million each policy, each loss.
Environmental Impairment Liability Excess of Loss 100% Authorized	50% of \$4.25 million each policy, each loss excess of \$20.75 million of gross liability.
Marine and Non-Marine	
Whole Account Excess of Loss (First Layer) 62% authorized 38% unauthorized	81.25% up to \$40 million, 91.25% placed thereafter of \$20 million any one loss excess of \$30 million for marine business and \$33.75 million for non-marine business any one loss.
Whole Account Excess of Loss (Second Layer) 51% authorized 49% unauthorized	91.25% up to \$60 million, 71.5% placed thereafter of \$20 million each and every loss excess of \$20 million which in turn is excess of \$30 million for marine business and \$33.75 million for non-marine business any one loss each and every loss.
Quota Share (All Lines) 100% authorized	100% of net retained liability on each and every risk for policies in force on January 1, 2000 and all new and renewal policies attaching thereafter.

The Company utilized facultative reinsurance for its marine cargo business as of December 31, 2001. Facultative cessions represented 3.6% of the Company's total premiums ceded in 2001.

The Company's zero retention is unchanged from the prior examination period. Most of the Company's reinsurance is with authorized reinsurers. Liberty Mutual is the reinsurer for the 100% all-lines quota share agreement, which was effective January 1, 2000 and was approved by this Department. The agreement provides for the Company to cede to Liberty Mutual all net policy liabilities remaining after its initial cessions with third party reinsurers. The agreement also provides that Liberty Mutual will reimburse the Company for any uncollectible reinsurance balances due from third party reinsurers. This agreement superceded a similar agreement dated January 1, 1996, between the Company and Peerless, which was terminated effective January 1, 2000. The Peerless agreement terminated on a cut-off basis except for any remaining environmental impairment liability business previously reinsured.

It was noted that material discrepancies existed between the Company's internal reinsurance records and the amounts it reported in its December 31, 2001 filed annual statement. These discrepancies included the following:

- Failure to report corresponding totals for reinsurance recoverable on paid losses and loss adjustment expenses in Schedule F and as an asset on page 2 of the annual statement;
- Failure to correctly segregate authorized and unauthorized insurers in Schedule F;
- Failure to maintain supporting documentation for and incorrectly reporting the offsets used to mitigate the liability "Provision for reinsurance";
- Failure to name the Company the beneficiary in letters of credit held by the Company; and

- Failure to provide sufficient source documentation to enable the examiner to verify paid losses and expenses, reinsurance recoverable balances, aging of recoverable balances and ceded reinsurance balances payable.

Additionally, it was noted that a significant number of executed interest and liability statements from assuming reinsurers were not dated. Because of the Company's failure to obtain properly dated interest and liability statements, it could not be determined whether several Company contracts were executed within the nine months, as prescribed in Paragraph 23 of SSAP No. 62 of the NAIC Accounting Practices and Procedures Manual.

It was noted that certain contracts placed through one Company reinsurance intermediary did not contain the insolvency clause required pursuant to Section 1308(a) of the New York Insurance Law.

Section 1308(a)(2)(A) states:

"No credit shall be allowed, as an admitted asset or deduction from liability, to any ceding insurer for reinsurance ceded, renewed, or otherwise becoming effective after January first, nineteen hundred forty, unless:

(i) the reinsurance shall be payable by the assuming insurer on the basis of the liability of the ceding insurer under the contracts reinsured without diminution because of the insolvency of the ceding insurer, and

(ii) under the reinsurance agreement the liability for such reinsurance is assumed by the assuming insurer as of the same effective date.

(B) Except as provided by subsection (a) of section four thousand one hundred eighteen of this chapter, no such credit shall be allowed any ceding insurer for reinsurance ceded, renewed, or otherwise becoming effective after September first, nineteen hundred fifty-two, unless the reinsurance agreement provides that payments by the assuming insurer shall be made directly to the ceding insurer or its liquidator, receiver or statutory successor, except where:

(i) the agreement specifies another payee of such reinsurance in the event of the insolvency of the ceding insurer, or

(ii) the assuming insurer with the consent of the direct insureds has assumed such policy obligations of the ceding insurer as its direct obligations to the payees under such policies, in substitution for the obligations of the ceding insurer to such payees.

(3) Such reinsurance agreement may provide that the liquidator, receiver or statutory successor of an insolvent ceding insurer shall give written notice of the pendency of a claim against such insurer on the contract reinsured within a reasonable time after such claim is filed in the insolvency proceeding and that during the pendency of such claim any assuming insurer may investigate such claim and interpose, at its own expense, in the proceeding where such claim is to be adjudicated any defenses which it deems available to the ceding company, its liquidator, receiver or statutory successor. Such expense shall be chargeable subject to court approval against the insolvent ceding insurer as part of the expense of liquidation to the extent of a proportionate share of the benefit which may accrue to the ceding insurer solely as a result of the defense undertaken by the assuming insurer. Where two or more assuming insurers are involved in the same claim and a majority in interest elect to interpose defense to such claim, the expense shall be apportioned in accordance with the terms of the reinsurance agreement as though such expense had been incurred by the ceding company”.

It was noted that several Company contracts placed through certain Company reinsurance intermediaries did not contain the reinsurance intermediary clause required pursuant to Part 125.6 (a)(1) of Department Regulation No. 20, which provides that:

“(a) Where a ceding insurer obtains reinsurance through a "reinsurance intermediary," as defined in Section 2101(f) of the Insurance Law, from an assuming insurer which is neither licensed in this state nor has placed funds with the ceding insurer pursuant to Section 1301(a)(14) of the Insurance Law, the ceding insurer shall not be allowed credit unless:

(1) the reinsurance agreement includes a provision whereby the reinsurer assumes all credit risks of the intermediary related to payments to the intermediary....”

As can be seen from the examination findings noted above, the Company’s internal control environment relative to its reinsurance operations was either poor or non-existent. It is recommended that

management institute internal controls so that information reported in its filed annual statements are a true indication of its reinsurance operations. Furthermore it is recommended that:

- The Company comply with the annual statement instructions, as well as the accounting practices and procedures set forth in SSAP No. 62 when completing its annual statement.
- The Company ensure that all executed interest and liability statements contain dates in order to determine whether Company reinsurance cession contracts are executed properly within the nine month period prescribed under paragraph 23 of SSAP No. 62.
- The Company amend its reinsurance contracts to comply with the insolvency clause required pursuant to Section 1308(a)(2) of the New York Insurance Law.
- The Company amend its reinsurance contracts to add the required reinsurance intermediary clause required by part 125.6(a)(1) of Department Regulation No. 20.

Notwithstanding the internal control deficiencies noted above, there have been no changes made to the liability reported by the Company in its filed annual statement for the “Provision for reinsurance”. The company’s all lines quota share agreement with Liberty Mutual provides that Liberty Mutual will reimburse the Company for any uncollectible balances due from third party reinsurers. However, although the credit risk for uncollectible reinsurance is mitigated by this provision of the all lines quota share agreement, it does not relieve the Company from its duty to report its reinsurance transactions in accordance with the New York Insurance Law, the Accounting Practices and Procedures Manual and the annual statement instructions issued by the National Association Insurance Commissioners, as adopted by this Department.

D.  Holding Company System

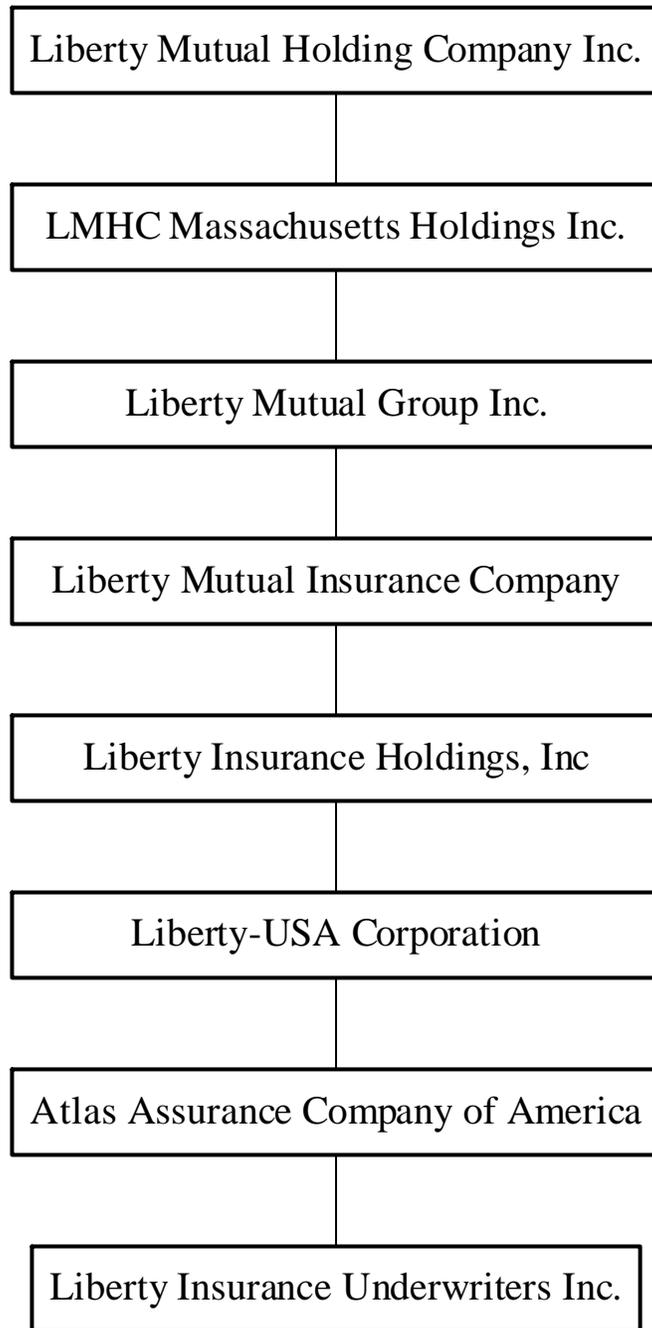
During 2001, Liberty Mutual formed a mutual holding company, Liberty Mutual Holding Company Inc. (“LMHCI”), a Massachusetts corporation. As part of the new mutual holding company

formation, Liberty Mutual reorganized into a stock insurer and became a wholly-owned subsidiary of Liberty Mutual Group Inc. (“LMGI”). In turn, LMGI is 100% controlled by LMHC Massachusetts Holdings Inc., a Massachusetts stock holding company, and a 100% controlled subsidiary of LMHCI.

The Department approved the reorganization on November 13, 2001 without requiring LMHCI to file an application on control of domestic insurer pursuant to Section 1506 of the New York Insurance Law. The Department’s decision to waive a review, pursuant to the provisions of Section 1506 of the New York Insurance Law, stemmed from LMHCI’s request for a filing exemption under Section 1502 of the New York Insurance Law. However, upon granting such waiver, the Department advised management that all other filing requirements of Article 15 of the New York Insurance Law and the Department’s Regulation 52 would have to be complied with by the Company on a prospective basis.

It was noted that the Company filed with the Department within thirty days following its change in control an initial HC-1 registration statement in compliance with Section 1503(a) of the New York Insurance Law and Part 11 NYCRR 80-1.2 of the Department’s Regulation 52. The Company filed its HC-1 annual registration statement within the 120 days following the end of its ultimate parent company’s fiscal year as required under Regulation 52.

The following is an abbreviated chart of the Company's holding company system as of December 31, 2001:



At December 31, 2001, the following inter-company agreements were in effect between the Company and certain affiliates:

Tax Sharing Agreement

The Company is party to the consolidated tax return of the Liberty Mutual Group effective July 30, 1990 and as amended January 25, 2002.

Services Agreement

Under the terms of this agreement effective May 10, 1999, Liberty Mutual may provide underwriting, claims, investment, accounting and other administrative services to the Company.

Investment Management Agreement

The Company receives investment managerial services from Liberty Mutual Insurance Company pursuant to an agreement effective May 26, 1999. The services are the management of the Company's investment portfolios such as: (1) debt obligations of the U.S. Government and other guaranteed U.S. Government Agencies, municipal obligations, corporate investment and non-investment grade bonds, (2) common and preferred stocks, (3) short-term obligations and (4) other authorized investment practices.

Property and Casualty Quota Share Reinsurance Agreement

The Company, pursuant to the captioned agreement effective January 1, 2000, cedes to Liberty Mutual Insurance Company, 100% of the net retained liability on all remaining business in excess of its reinsurance cessions with third party assuming reinsurers.

### Cash Management Agreement

Pursuant to the captioned agreement effective January 28, 2000, Liberty Mutual Investment Advisors LLC, manages the short-term investments portfolio of the Company through the Liberty Mutual Property & Casualty Liquidity Investments Pool.

### Investment Management Agreement

Pursuant to the captioned agreement effective May 1, 2000, Liberty Mutual Investment Advisors LLC is responsible for managing the Company's investments portfolio comprising of debt obligations (non-investment grade), equity (public common stock) investments and limited partnership interests.

Although previously exempt under Article 15 of the New York Insurance Law, it was noted that the Company filed its quota share and cash management agreements with the Department during the examination period and prior to Liberty Mutual's mutual holding company formation.

It is recommended that the Company file all new inter-company agreements and current amendments to existing agreements pursuant to the requirements of Section 1505(c) and (d) of the New York Insurance Law.

During 1999, the Company filed consolidated federal income tax returns with other Liberty Mutual Group ("LMG") affiliates based upon LMG's existing tax sharing agreement dated July 30, 1990 and as subsequently amended January 25, 2002. This tax agreement was implemented without the Department's approval pursuant to Circular Letter No. 33 (1979). This Circular Letter requires the Company give notification to the Department within thirty days of any amendment to or termination of a

tax allocation agreement. During the course of this examination, the Company filed the agreement, which was subsequently approved by the Department.

It is recommended that the Company comply with Circular Letter No. 33 (1979) involving any future tax allocation agreements in which it participates into by the Company by supplying the Department with thirty days notification prior to any amendment to or termination of such agreements.

Pursuant to the inter-company agreements, shared expenses (underwriting and administrative) between the Company and its affiliates are allocated as a percentage of each entity's gross written premiums with the Company's expenses thereafter reallocated all to Liberty Mutual pursuant to the parties' property & casualty quota share agreement. Investment fees incurred by the Company under its investment management agreements are determined by each affiliate's share of cash and invested assets to the total investment pools.

E. Abandoned Property Law

Section 1316 of the New York Abandoned Property Law provides that amounts payable to a resident of this state from a policy of insurance, if unclaimed for three years, shall be deemed to be abandoned property. Such abandoned property shall be reported to the New York State Comptroller Office on or before the first day of April each year. Such filing is required of all insurers regardless of whether or not they have any abandoned property to report.

The Company failed to file any abandoned property reports for the period under examination pursuant to the provisions of Section 1316 of the New York Abandoned Property Law. As of the

examination period, management has not implemented a formal abandoned property policy for the escheatment of unclaimed funds.

It is recommended that the Company establish an abandoned property policy and file its abandoned property reports on a timely basis pursuant to the provisions of Section 1316 of the New York Abandoned Property Law.

F. Significant Operating Ratios

The following ratios have been computed as of December 31, 2001, based upon the results of this examination:

Net premiums written to Surplus as regards policyholders	0.0 to 1
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	82%
Premiums in course of collection to Surplus as regards policyholders	0%

Ratios one and three have zero values as a result of the Company ceding 100% of its net premiums to Liberty Mutual. Ratio two falls within the benchmark range set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

G. Audited Financial Statement

Section 307(b)(1) of the New York Insurance Law states:

“Every licensed insurer, except an assessment co-operative property/casualty insurance company having direct premiums written in this state of less than two hundred fifty thousand dollars in any calendar year and having less than five hundred policyholders at the end of such calendar year, shall be required to file within five months of the end of

such calendar year, an annual financial statement (including an annual financial statement of any subsidiary of the type described in paragraph nine of subsection (a) of section one thousand four hundred four or subparagraph (B) of paragraph four of subsection (a) of section one thousand four hundred seven of this chapter) together with an opinion thereon of an independent certified public accountant on the financial statement of such insurer and any such subsidiary, which statement and opinion shall be available for public inspection at the office of the superintendent and the principal office of the insurer”.

The Company did not file its audited financial statement within the timeframe set forth in Section 307(b)(1) of the New York Insurance Law. It is recommended that management file all Company certified public accountants audited annual statements and reports on a timely basis pursuant to Section 307(b)(1) of the New York Insurance Law.

#### H. Accounts and Records

The Company could not provide the necessary source documentation to enable verification of a significant number of transactions between Liberty Mutual and the Company. These transactions include the quota share accounting and daily account sweep. It is recommended that the Company establish an internal control structure that includes a systematic audit trail to enable the proper verification of the account balances.

It was noted that the Company did not reconcile its inter-company receivable and payable accounts as of year-end 2001. This resulted in an adjustment to the Company’s December 31, 2001 inter-company payable account in 2002 in the amount of \$14,564,428. This is discussed further in item 8 herein. It is recommended that the Company routinely reconcile its inter-company accounts between the receivable and payable accounts and resolve all unapplied or misapplied amounts accordingly.

The examiner noted that the corporate minutes were maintained in Boston, Massachusetts. In addition, some of the Company’s books of account were located outside of New York. The cash and

investment records were maintained in Boston, Massachusetts and the reinsurance records were located in Dallas, Texas, London, England and Australia.

Section 325(a) of the New York Insurance Law states:

“Every domestic insurer and every licensed United States branch of an alien insurer entered through this state shall, except as hereinafter provided, keep and maintain at its principal office in this state its charter and by-laws (in the case of a United States branch a copy thereof) and its books of account, and if a domestic stock corporation a record containing the names and addresses of its shareholders, the number and class of shares held by each and the dates when they respectively became the owners of record thereof, and if a domestic corporation the minutes of any meetings of its shareholders, policyholders, board of directors and committees thereof”.

The Company violated Section 325(a) of the New York Insurance Law by failure to maintain its minute books and accounts and records in this state. It is recommended that management maintain the corporate minutes and accounts and records of the Company in the State of New York in compliance with Section 325(a) of the New York Insurance Law.

I. Facilitation of Examination

Section 310(a)(3) of the New York Insurance Law states:

“The officers and agents of such insurer or other person shall facilitate such examination and aid such examiner in conducting the same so far as it is in their power to do so.”

All examination requests were transmitted in writing to Company management. Examination correspondence consisted of 56 written requests. The average response time was thirty eight days.

It is recommended that management take the necessary steps to ensure cooperation with the examiners on future examinations as indicated per Section 310 of the New York Insurance Law.

### 3. FINANCIAL STATEMENTS

#### A. Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as determined by this examination as of December 31, 2001 and as reported by the Company:

<u>Assets</u>	<u>Examination</u>		<u>Company</u>		<u>Surplus Increase (Decrease)</u>
	<u>Assets</u>	<u>Assets Not Admitted</u>	<u>Net Admitted Assets</u>	<u>Net Admitted Assets</u>	
Bonds	\$11,253,862	\$	\$11,253,862	\$11,253,862	\$
Cash and short-term investments	69,506,783	14,753,170	54,753,613	69,506,783	(14,753,170)
EDP equipment and software	287,036		287,036	287,036	
Interest, dividends and real estate Income due and accrued	417,091		417,091	417,091	
Other assets non-admitted	1,017,129	1,017,129			
Aggregate write-ins for other than Invested assets	<u>1,081,915</u>	<u>1,081,915</u>	_____	<u>1,081,915</u>	<u>(1,081,915)</u>
Total assets	<u>\$83,563,816</u>	<u>\$16,852,214</u>	<u>\$66,711,602</u>	<u>\$82,546,687</u>	<u>\$(15,835,085)</u>

<u>Liabilities, Surplus and Other Funds</u>	<u>Examination</u>	<u>Company</u>	<u>Surplus Increase (Decrease)</u>
Losses	\$	\$	\$
Loss adjustment expenses			
Federal and foreign income taxes	375,397	375,397	
Provision for reinsurance	2,755,951	2,755,951	
Payable to parent, subsidiaries and affiliates	47,253,841	62,007,011	(14,753,170)
Aggregate write-ins for liabilities	<u>1,567,268</u>	<u>1,567,268</u>	<u>                    </u>
Total liabilities	<u>\$51,952,457</u>	<u>\$66,705,627</u>	<u>\$(14,753,170)</u>
 <u>Surplus and Other Funds</u>			
Common capital stock	\$ 3,500,000	\$3,500,000	\$
Aggregate write-ins for other than special surplus funds	696,112	696,112	
Gross paid in and contributed surplus	10,029,767	10,029,767	
Unassigned funds (surplus)	<u>533,266</u>	<u>1,615,180</u>	<u>(1,081,914)</u>
Surplus as regards policyholders	<u>\$14,759,145</u>	<u>\$15,841,059</u>	<u>\$(1,081,914)</u>
Total liabilities, surplus and other funds	<u>\$66,711,602</u>	<u>\$82,546,686</u>	<u>\$(15,835,084)</u>

NOTE: Current management is unaware whether the Internal Revenue Service completed audits of the Company during the years 1997 and 1998 while the Company still remained under its formal Guardian Royal Exchange ownership. Management indicated the Internal Revenue Service is presently auditing the Company's tax returns for the 2000 and 2001 tax years. The examiner is unaware of any potential exposure of the Company to any tax assessments and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders decreased \$3,069,707 during the five-year examination period January 1, 1997 through December 31, 2001, detailed as follows:

Underwriting Income

Premiums earned \$0

Investment Income

Net investment income earned	\$5,221,264	
Net realized capital gains	<u>(113,588)</u>	
Net investment gain or (loss)		<u>5,107,676</u>
Net income after dividends to policyholders but before federal And foreign income taxes		\$5,107,676
Federal and foreign income taxes incurred		<u>1,461,284</u>
Net income		<u>\$3,646,392</u>

C. Capital and Surplus Account

Surplus as regards policyholders per report on Examination as of December 31, 1996			\$17,828,850
	<u>Gains in Surplus</u>	<u>Losses in Surplus</u>	
Net income	\$3,646,392		
Change in non-admitted assets		\$ 1,615,452	
Change in provision for reinsurance		1,980,710	
Change in surplus notes	103,354		
Surplus adjustments paid in		1,473,291	
Dividends to stockholders	<u>                    </u>	<u>1,750,000</u>	
Net increase (decrease) in surplus	<u>\$3,749,746</u>	<u>\$6,819,453</u>	<u>(3,069,707)</u>
Surplus as regards policyholders per report on examination as of December 31, 2001			<u>\$ 14,759,143</u>

#### **4. CASH AND SHORT TERM INVESTMENTS**

The examination admitted asset of \$54,753,613 is \$14,753,170 less than the \$69,506,783 reported by the Company in its December 31, 2001 filed annual statement. The examination change reflects numerous 2001 reinsurance payments that were not applied to the Company's cash and inter-company payable (in Section 8) accounts. These unrecorded payments were discovered in 2002. The payments were undetected in 2001 due to the Company's practice of not performing regular reconciliations on its cash accounts. It was also noted that cash receipts applicable to the Company's other Liberty International Underwriters' affiliates were improperly included into the Company's cash account. It is recommended that the Company strengthen its internal controls so that accounts are reconciled on a monthly basis.

It was noted that the Company had unapplied cash totaling \$30 million that was not identified at year-end 2001. It is recommended that the Company investigate all unapplied cash amounts and apply such amounts to the appropriate Company accounts in a timely manner.

The Company reported short-term investments totaling \$47,898,204 as of December 31, 2001. Such investments consisted of two separate JP Morgan Chase money market accounts. The larger account had a reported balance of \$44,068,084. This account is comprised of the pooled investments of the Company and other affiliates that are under common management by Liberty Mutual Investment Advisors LLC ("LMIA") pursuant to the parties inter-company cash management agreement described in Section 2D of this report. It was noted that the account was held in the name of the investment manager (LMIA) as opposed to the names of the pool's participants.

As of December 31, 2001, the Company's share of the pooled investment was \$44,068,084, which represented 53% of the Company's total admitted assets. Section 1409 of the New York Insurance Law provides as follows:

“...no domestic insurer shall have more than ten percent of its admitted assets as shown by its last statement on file with the superintendent invested in, or loaned upon, the securities (including for this purpose certificates of deposit, partnership interests and other equity interests) of any one institution.”

Therefore the Company exceeded the investment limitation set forth in Section 1409 of the New York Insurance Law. It is recommended that the Company monitor its investment portfolio to ensure that it has not exceeded any of the investment limitations set forth in the New York Insurance Law.

It was also noted that the cash management agreement contained a provision that the Company's share of the total investment could not exceed 10%. At December 31, 2001 the Company's share of the total investment was approximately 11%. Thus, it appears that the Company was not complying with the provisions of its investment management agreement. It is recommended that the Company monitor its activity under this agreement.

It was noted that during 2002, the Company had divested itself of the excess investment. Thus, no changes have been made to the Company's financial statements for this excess investment.

A review of the underlying agreement revealed that it lacked certain provisions that are indicative of proper internal controls for this type of investment agreement.

The agreement should be amended to state that the assets of the investment pool will be maintained in one or more accounts, in the name of or on behalf of the investment pool, under a custody agreement with a qualified bank. The custody agreement shall:

- a) State and recognize the claims and rights of each participant;
- b) Acknowledge that the underlying assets of the investment pool are held solely for the benefit of each participant in proportion to the aggregate amount of its investments in the investment pool; and
- c) Contain an agreement that the underlying assets of the investment pool shall not be commingled with the general assets of the custodian-qualified bank, pool manager, or any other person.

It is recommended that the cash management agreement be amended to include the provisions set forth above.

#### **5. AGGREGATE WRITE-INS FOR OTHER THAN INVESTED ASSETS**

The admitted asset of \$1,081,915 reported by the Company in its December 31, 2001 filed annual statement has been eliminated. \$896,378 of this non-admitted item stemmed from a disputed inter-company receivable account that the Company wrote off as uncollectible. This inter-company receivable resulted from an old service agreement between the former Albany Insurance Company and another affiliate that pre-dated Albany's (now Liberty Insurance Underwriters Inc.) acquisition by Liberty Mutual. The remaining \$185,537 balance from the total non-admitted item was comprised of lease deposits, cash advances to Company officers and prepaid expenses.

## 6. LOSSES AND LOSS ADJUSTMENT EXPENSES

The Company reported no loss and loss adjustment expense reserves as of December 31, 2001. The Company cedes 100% of its net losses and loss adjustment expenses to Liberty Mutual based on a quota share reinsurance agreement between the affiliates.

## 7. PROVISION FOR REINSURANCE

The examination liability of \$2,755,951 is the same amount reported by the Company in its December 31, 2001 filed annual statement. Examination review indicated that the Company made numerous errors in reporting and calculating this liability. Additionally, the Company's supporting documentation for amounts reported in Schedule F was inadequate. However, since the Company's reinsurance agreement with Liberty Mutual provides that Liberty Mutual will reimburse the Company for any uncollectible reinsurance, there has been no change to the liability.

It is recommended that the Company maintain adequate documentation to verify the account and to comply with the annual statement instructions for this liability.

Furthermore, it is recommended that the Company calculate this liability in accordance with the annual statement instructions.

### Department Regulation 133

It was noted that except for one case, all Company letters of credit were in the name of Liberty International Underwriters as beneficiary instead of Liberty Insurance Underwriters, Inc.

Part 79(d)(2) of the Department's Regulation 133 requires that the domestic ceding company be the beneficiary, as defined in Part 79.1(b), as a requirement for acceptable letters of credit. Management was advised of such requirement and has subsequently amended all Company existing letters of credit to identify the Company as beneficiary as required per Regulation 133 of the Insurance Department.

However, it is recommended that the Company refrain from securing in the future letters of credit otherwise not held in the Company's name as required under Part 79.(d)(2) of Regulation 133.

#### **8. PAYABLE TO PARENT, SUBSIDIARIES AND AFFILIATES**

The examination liability for the captioned account of \$47,253,841 is \$14,753,170 less than the \$62,007,011 reported by the Company in its December 31, 2001 filed annual statement.

The examination review determined that there were 2001 reinsurance payments that were not recorded to the account. These unrecorded payments were discovered subsequently in 2002. Based on the Company's 100% quota share reinsurance agreement with Liberty Mutual, the correction for the unrecorded payments involved as decrease to the company's inter-company payable account.

Furthermore, management furnished records that were insufficient to verify the settlement of the 2001 year-end account balance in the subsequent period.

It is recommended that the Company apply all payments made to this account in order to report the proper account balance in the annual statement. Also, it is further recommended that management maintains documentation that clearly supports the settlement of this captioned account.

## **9. MARKET CONDUCT ACTIVITIES**

In the course of this examination, a review was made of the manner in which the Company conducts its business and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed to encompass the more precise scope of a market conduct investigation, which is the responsibility of the Market Conduct Unit of the Property Bureau of this Department.

The general review was directed at practices of the Company in the following areas:

- A. Sales and advertising
- B. Underwriting
- C. Rating
- D. Claims and complaint handling

No problem areas were encountered.

## 10. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
<p>A.     <u>Management</u></p> <p>It is again recommended that the Company hold annual shareholders' meetings as required by its charter.</p> <p>This recommendation is not applicable to the current examination as the Company is now under the ultimate control of Liberty Mutual Insurance Company.</p>	<p>4</p>
<p>B.     <u>Reinsurance</u></p> <p>It is recommended that the Company and GRE Insurance Group file all future amendments to its assumed and ceded reinsurance contracts with the New York Insurance Department, pursuant to Article 15 of the New York Insurance Law.</p> <p>This recommendation is not applicable to the current examination as the Company is now under the ultimate control of Liberty Mutual Insurance Company.</p>	<p>11</p>
<p>C.     <u>Approval of Investments</u></p> <p>It is recommended that the board of directors, or a formal committee thereof, approve all investments made by the Company in a timely manner, in accordance with Section 1411(a) of the New York Insurance Law.</p> <p>While the comment in the prior report was directed to prior management, a similar recommendation is contained in the current report.</p>	<p>14</p>

<u>ITEM</u>	<u>PAGE NO.</u>
D. <u>Conflict of Interest Statements</u>	
It is recommended that all officers, directors and key employees sign conflict of interest statements during each calendar year.	14
This recommendation is not applicable to the current examination since the Company is now under the ultimate control of Liberty Mutual Insurance Company. Current management now requires annual conflict of interest disclosures by current officers, directors, and key employees.	
E. <u>Holding Company System</u>	
It is recommended that the Company develop and maintain a method of allocation of expenses and fees with the parent company that complies with the provisions of Regulation 30 of the New York Insurance Law.	12
The Company has complied with this recommendation.	
F. <u>Bank Statements – Cash Accounts</u>	
It is recommended that bank statements to the Company’s cash accounts are corrected to reflect the correct account number and company names in order that cash accounts be distinguished clearly between companies.	14
This recommendation is not applicable to the current examination as the Company is now under the ultimate control of Liberty Mutual Insurance Company.	
G. <u>Corporate Records</u>	
It is recommended that the Company maintain documents supporting the annual statement in a manner in which access to the records may be provided timely and efficiently. It is also recommended that the Company provide future examination documents and respond to questionnaires in a timely manner pursuant to Section 310 of the New York Insurance Law.	15
While this recommendation was presented to the Company’s former management prior to the acquisition of control by Liberty Mutual, a similar situation was noted during the current examination.	

<u>ITEM</u>	<u>PAGE NO.</u>
H. <u>Agents' Balances</u>	
It is recommended that the Company settle its balance with its subsidiaries in a time manner or write-off the overdue amount.	19
This recommendation is not applicable to the current examination as the Company is now under the ultimate control of Liberty Mutual Insurance Company.	

## **11. SUMMARY OF COMMENTS AND RECOMMENDATIONS**

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
It is recommended that the Company's board of directors hold at least one board meeting each year.	5
It is recommended that the Company comply with Section 1411(a) of the New York Insurance Law and require board approval of all investment transactions. Such investment activities shall be documented in the board of directors' minutes.	5
B. <u>Territory and Plan of Operation</u>	
It is recommended that the Company cease and desist from reinsuring and insuring risks outside the United States in violation of Sections 4102(c) and 4103(a)(4) of the New York Insurance Law.	9
C. <u>Reinsurance</u>	
It is recommended that the Company report its direct and assumed premiums written in accordance with the annual statement instructions.	10
It is recommended that the management institute internal controls so that the information reported in its filed financial statements is a true indication of its reinsurance operations. .	15

<u>ITEM</u>	<u>PAGE NO.</u>
It is recommended that the Company complies with the NAIC's Annual Statement Instructions, as well as SSAP No. 62 of the NAIC Accounting Practices and Procedures Manual when completing its annual statement.	16
It is recommended that the Company ensure that all executed interest and liability statements contain dates in order to determine whether Company reinsurance cession contracts were executed properly within the nine month period prescribed under paragraph 23 of SSAP No. 62.	16
It is recommended that the Company amend its reinsurance contracts to comply with the insolvency clause required pursuant to Section 1308(a)(2) of the New York Insurance Law.	16
It is recommended that the Company amend its reinsurance contracts to add the required reinsurance intermediary clause required by part 125.6(a)(1) of Department Regulation No. 20.	16
 D. <u>Holding Company System</u>	
It is recommended that the Company file all new inter-company agreements and current amendments to the existing agreements with this Department pursuant to Section 1505(c) and (d) of the New York Insurance Law.	20
It is recommended that the Company comply with Department Circular Letter No. 33 (1979) by giving thirty days prior notification to the Department regarding any amendments to or termination of its tax allocation agreements.	21
 E. <u>Abandoned Property Law</u>	
It is recommended that the Company establish an abandoned property policy and file its abandoned property reports on a timely basis pursuant to Section 1316 of the New York Abandoned Property Law.	22
 G. <u>Audited Annual Statement</u>	
It is recommended that management file its certified public accountants audited annual statement timely in compliance with Section 307(b)(1) of the New York Insurance Law.	23

<u>ITEM</u>	<u>PAGE NO.</u>
H. <u>Accounts and records</u>	
It is recommended that the Company establish an internal control structure that includes a systematic audit trail to enable the proper verification of the account balances.	23
It is recommended that the Company routinely reconcile its inter-company receivable and payable accounts and resolve all unapplied and misapplied amounts accordingly.	23
It is recommended that management maintains copies of the Company's board of directors' minutes and accounts and records per Section 325(a) of the New York Insurance Law.	24
I. <u>Facilitation of Examination</u>	
It is recommended that management takes the necessary steps to fully cooperate with the examiners in future examinations of the Company by furnishing all information requested in compliance with Section 310 of the New York Insurance Law.	24
J. <u>Cash and Short-Term Investments</u>	
It is recommended that the Company strengthen its internal controls over its cash accounts by reconciling its accounts on a monthly basis.	29
It is recommended that the Company investigate all unapplied cash amounts and apply to the appropriate accounts in a timely manner.	29
It is recommended that the Company monitor its investment portfolio at all times to ensure compliance with Section 1409 of the New York Insurance Law.	30
It is recommended that the company monitor its activity to ensure compliance with the cash management agreement.	30
It is recommended that the cash management agreement be amended to include the provisions stated in this report.	31

<u>ITEM</u>		<u>PAGE NO.</u>
K.	<u>Provision for Reinsurance</u>	
	It is recommended that the Company maintain adequate documentation to verify the account and comply with the annual statement instructions for this liability.	32
	It is recommended that the Company report the liability Provision for reinsurance in accordance with the annual statement instructions.	32
	It is recommended that the Company refrain from securing letters of credit otherwise not held in the Company's name as required under Department Regulation 133.	33
L.	<u>Payable to Parent, Subsidiaries and Affiliates</u>	
	It is recommended that the Company record all payments made to the account in order to report the proper account balance in the annual statement.	34
	It is recommended that management maintain documentation that clearly supports the settlement of the Company's inter-company payable account.	34

Respectfully submitted,

\_\_\_\_\_/S/  
Kenneth Merritt  
Senior Insurance Examiner

STATE OF NEW YORK    )  
                                  )  
                                  SS:  
                                  )  
COUNTY OF NEW YORK )

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

\_\_\_\_\_/S/  
KENNETH MERRITT

Subscribed and sworn to before me

this \_\_\_\_\_ day of \_\_\_\_\_, 2004

State of New York  
County of New York

EXAMINER'S AFFIDAVIT AS TO STANDARDS AND PROCEDURES  
USED IN AN EXAMINATION

JOSEPH M. PIRES, CFE, CIE, BEING DULY SWORN, STATES AS FOLLOWS:

1. I have authority to represent the State of Mississippi in the examination of the Liberty Insurance Underwriters, Inc.
2. Mississippi is accredited under the National Association of Insurance Commissioners' Financial Regulation Accreditation Standards.
3. I have reviewed the examination work papers and examination report. The examination of the Liberty Insurance Underwriters, Inc was performed in a manner consistent with the standards and Procedures required by the State of Mississippi.

The affiant says nothing further.

Joseph M. Pires, CFE, CIE  
State of Mississippi Insurance Examiner's Signature

Subscribed and sworn before me by Joseph Pires on this 29<sup>th</sup> day of April 2005

**ALEXANDER A PRIEST**  
Notary Public - State of New York  
NO. 01PR4760386  
Qualified in Bronx County  
Commission Expires April 30, 2006

Alexander Priest  
Notary Public

My commission expires 4/30/2006 (date)

**ALEXANDER A PRIEST**  
Notary Public - State of New York  
NO. 01PR4760386  
Qualified in Bronx County  
Commission Expires April 30, 2006

State of New York  
County of New York

EXAMINER'S AFFIDAVIT AS TO STANDARDS AND PROCEDURES  
USED IN AN EXAMINATION

PIERRE J. GLOVER, CFE, BEING DULY SWORN, STATES AS FOLLOWS:

1. I have authority to represent the State of Nevada in the examination of the Liberty Insurance Underwriters, Inc.
2. Nevada is accredited under the National Association of Insurance Commissioners' Financial Regulation Accreditation Standards.
3. I have reviewed the examination work papers and examination report. The examination of the Liberty Insurance Underwriters, Inc was performed in a manner consistent with the standards and Procedures required by the State of Nevada.

The affiant says nothing further.

Pierre J. Glover, CFE  
State of Nevada Insurance Examiner's Signature

Subscribed and sworn before me by Pierre Glover on this 29<sup>th</sup> day of April 2005

**ALEXANDER A PRIEST**  
Notary Public - State of New York  
NO. 01PR4760386  
Qualified in Bronx County  
Commission Expires April 30, 2006

Alexander Priest  
Notary Public

My commission expires 4/30/2006 (date)

**ALEXANDER A PRIEST**  
Notary Public - State of New York  
NO. 01PR4760386  
Qualified in Bronx County  
Commission Expires April 30, 2006

Appointment No. 21832

STATE OF NEW YORK  
INSURANCE DEPARTMENT

I, GREGORY V. SERIO, Superintendent of Insurance of the State of New York,  
pursuant to the provisions of the Insurance Law, do hereby appoint:

**Kenneth Merritt**

*as proper person to examine into the affairs of the*

**LIBERTY INSURANCE UNDERWRITERS, INC.**

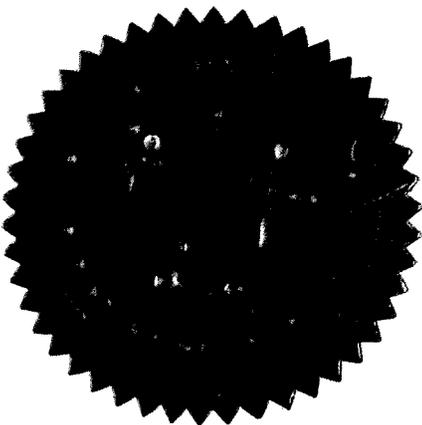
*and to make a report to me in writing of the condition of the said*

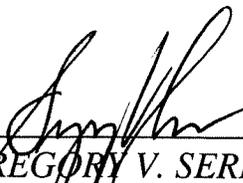
**Corporation**

*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 30th day of January, 2002*



  
\_\_\_\_\_  
GREGORY V. SERIO  
Superintendent of Insurance