

REPORT ON EXAMINATION

OF THE

HUDSON SPECIALTY INSURANCE COMPANY

AS OF

DECEMBER 31, 2010

DATE OF REPORT

JANUARY 3, 2012

EXAMINER

MARIBEL C. NUNEZ, C.P.C.U

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NEW YORK STATE  
DEPARTMENT *of*  
FINANCIAL SERVICES

Andrew M. Cuomo  
Governor

Benjamin M. Lawsky  
Superintendent

January 3, 2012

Honorable Benjamin M. Lawsky  
Superintendent of Financial Services  
Albany, New York 12257

Sir:

Pursuant to the requirements of the New York Insurance Law, and in compliance with the instructions contained in Appointment Number 30623 dated January 4, 2011, attached hereto, I have made an examination into the condition and affairs of Hudson Specialty Insurance Company as of December 31, 2010, and submit the following report thereon.

Wherever the designation “the Company” appears herein without qualification, it should be understood to indicate Hudson Specialty Insurance 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 office located at 17 State Street, New York, New York.

## **1. SCOPE OF EXAMINATION**

The Department has performed a single-state examination of Hudson Specialty Insurance Company. The previous examination was conducted as of December 31, 2005. This examination covered the five-year period from January 1, 2006 through December 31, 2010. Transactions occurring subsequent to this period were reviewed where deemed appropriate by the examiner.

This examination was conducted in accordance with the National Association of Insurance Commissioners (“NAIC”) Financial Condition Examiners Handbook (“Handbook”), which requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company including corporate governance, identifying and assessing inherent risks within the Company and evaluating system controls and procedures used to mitigate those risks. 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. This examination also included a review and evaluation of the Company’s own control environment assessment and an evaluation based upon the Company’s Sarbanes Oxley documentation and testing. The examiners also relied upon audit work performed by the Company’s independent public accountants when appropriate.

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

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

A review was also made to ascertain what action was taken by the Company with regard to comments and recommendations contained in the prior report on examination.

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

## **2. DESCRIPTION OF COMPANY**

The Company was incorporated under the laws of the State of New York on December 13, 1984 as the Southwest International Reinsurance Company of New York (“Southwest NY”) to serve as the vehicle for the re-domestication of the Southwest International Reinsurance Company (“Southwest TX”), a Texas insurer. Effective December 31, 1985, Southwest TX merged with and into Southwest NY and the surviving Company adopted the name of its predecessor. On August 30, 1993, the name of the Company was changed to General Security Indemnity Company.

Prior to July 3, 1990, the Company was 51% owned by The Dai-Tokyo Fire and Marine Insurance Company, Ltd. (“Dai-Tokyo”), Tokyo, Japan, and 49% owned by SCOR Reinsurance Company (“SCOR Re”), New York, NY. On July 3, 1990, SCOR U.S. Corporation, the immediate parent of SCOR Re, purchased Dai-Tokyo’s 51% interest in the Company and subsequently contributed that interest to SCOR Re.

On October 28, 2003, Odyssey America Reinsurance Corporation (“Odyssey America”), a Connecticut domiciled reinsurance company, purchased 100% of the capital stock of the Company from SCOR Re. Odyssey America is ultimately controlled by Fairfax Financial Holdings Limited (“Fairfax”), a publicly traded Canadian financial services holding company. As part of the acquisition, all of the Company’s liabilities for business written prior to the purchase date were transferred to General Security Indemnity Company of Arizona through an “Assumption Reinsurance, Indemnification and Administration Agreement.” Effective December 29, 2003, the Company changed its name to Hudson Specialty Insurance Company.

On December 30, 2003, Odyssey America transferred ownership of the Company to its wholly-owned subsidiary, Clearwater Insurance Company (“Clearwater”), a Delaware domiciled insurer. On July 29, 2010, Clearwater transferred ownership of the Company to its wholly-owned subsidiary, Hudson Insurance Company, a Delaware domiciled insurer. Subsequent to the

examination date, on January 1, 2011, Clearwater transferred its ownership of Hudson Insurance Company to Odyssey America and as a result, the Company is now an indirect, wholly-owned subsidiary of Odyssey America.

As of December 31, 2010, capital paid in was \$7.5 million consisting of 25,000 shares of \$300 par value per share common stock. Gross paid in and contributed surplus was \$33.5 million. There have been no changes to paid in capital or gross paid in and contributed surplus since the prior examination.

A. Management

Pursuant to the Company's charter and by-laws, management of the Company is vested in a Board of Directors consisting of no less than thirteen, or more than twenty-one members. As of the examination date, the board of directors was comprised of thirteen members. The directors as of December 31, 2010 were as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Andrew Acheson Barnard New York, NY	Chief Executive Officer, Odyssey America Reinsurance Corporation
Robert Stanley Bennett Stamford, CT	Executive Vice President & Chief Actuary, Hudson Specialty Insurance Company
Jan Christiansen Barrington, IL	Executive Vice President, Odyssey America Reinsurance Corporation
Richard Frederick Coerver IV Fairfield, CT	Senior Vice President & Controller, Odyssey America Reinsurance Corporation
Christopher Liam Gallagher New York, NY	President, Hudson Specialty Insurance Company
Kimber Jan Lantry Hercules, CA	Executive Vice President, Hudson Specialty Insurance Company
Peter Hamilton Lovell Glastonbury, CT	Senior Vice President, General Counsel & Corporate Secretary, Hudson Specialty Insurance Company
Stephen Lawrence Porcelli Rensselaer, N	Senior Vice President, Hudson Specialty Insurance Company

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
James Brian Salvesen Ridgefield, CT	Senior Vice President & Chief Financial Officer, Odyssey America Reinsurance Corporation
Christopher Thomas Suarez Hamburg, New Jersey	Executive Vice President, Hudson Specialty Insurance Company
John Francis Verbich West Windsor, NJ	Senior Vice President & Chief Financial Officer, Hudson Specialty Insurance Company
Michael Gerard Wacek Greenwich, CT	Executive Vice President, Odyssey America Reinsurance Corporation
Brian David Young New York, NY	Chief Executive Officer, Hudson Specialty Insurance Company

During the period under examination, the board of directors did not hold any regular or special scheduled meetings. Instead, the Company made all its decisions thru written consent with the approval/signature of all board members.

This is against the Company's by-laws which states in part:

“ . . . where time is of the essence, but not in lieu of any regular or special scheduled meeting of the board of directors or any committee thereof, any action required or permitted to be taken by the board of directors or any committee thereof, may be taken without a meeting if all members of the board, or of such committee, consent in writing to the adoption of a resolution authorizing action. . . ”

It is recommended that the Company convene regularly scheduled quarterly meetings of its board of directors as stated in its by-laws and maintain complete minutes of such proceedings.

As of December 31, 2010, the principal officers of the Company were as follows:

<u>Name</u>	<u>Title</u>
Brian David Young	Chief Executive Officer
Christopher Liam Gallagher	President & Chief Operating Officer
Peter Hamilton Lovell	Senior Vice President, General Counsel & Corporate Secretary
Anthony Joseph Slowski	Senior Vice President & Treasurer

B. Territory and Plan of Operation

As of December 31, 2010, the Company was licensed to write business in New York only. It also operates as a surplus lines carrier on a non-admitted basis in the other forty-nine states and the District of Columbia, Puerto Rico and the United States Virgin Islands.

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>
3	Accident and health
4	Fire
5	Miscellaneous property
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
17	Credit
19	Motor vehicle and aircraft physical damage
20	Marine and inland marine
21	Marine protection and indemnity

The Company is also empowered to transact such workers' compensation insurance as may be incident to coverage contemplated under paragraphs 20 and 21 of Section 1113(a) of the New York Insurance Law, including insurances described in the Longshoremen's and Harbor Workers' Compensation Act (Public law 803, 69th Congress as amended; 33 USC Section 901 et. seq. as amended). In addition, the Company is licensed to write Special Risk Insurance pursuant to Article 63 of the New York Insurance Law.

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 \$4,400,000.

The Company is a direct writer. More than half of its business consists of medical malpractice business written directly by the Company. The remaining business consists mainly of other liability and is produced by program administrators (“PAs”). The medical malpractice claims are handled directly, but the majority of claims from business produced by PAs are handled by third party administrators.

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

<u>Calendar Year</u>	<u>New York State</u>	<u>Total United States</u>	<u>Premiums Written in New York State as a Percentage of United States Premium</u>
2006	\$1,481,574	\$248,974,359	0.60%
2007	\$ 913,379	\$221,703,677	0.41%
2008	\$1,206,015	\$187,098,240	0.64%
2009	\$2,053,925	\$150,964,243	1.36%
2010	\$1,908,920	\$125,298,551	1.52%

### C. Reinsurance

The Company had not assumed any premiums as of December 31, 2010.

As part of the acquisition of the Company by Odyssey America in 2003, all of the Company’s liabilities for business written prior to October 28, 2003 were transferred to General Security Indemnity Company of Arizona (“GSIC-AZ) through an “Assumption Reinsurance, Indemnification and Administration Agreement.” In conjunction with the agreement, and as a condition precedent to the sale of the Company, GSIC-AZ established a trust for the benefit of the Company to secure the full amount of the gross liabilities of the Company assumed by GSIC-AZ. GSIC-AZ has endeavored to obtain novation agreements from all insureds with outstanding liabilities. However, any policies that are not novated are 100% reinsured by GSIC-AZ.

The Company has structured its ceded reinsurance program as follows:

Type of TreatyCoverageEmployment Practices Liability100% Quota Share100% Authorized

Covers employment practices liability. Coverage is limited to \$100,000 each wrongful employment act and in the aggregate. This limit can be increased to \$1,000,000 with special permission by the reinsurer.

Professional Liability Excess of Loss

(3 Layers)

100% Authorized

\$9,500,000 excess of \$500,000 ultimate net loss, each policy, each insured, each occurrence or claim made. Aggregate limitations are \$14,400,000 or 300% of the reinsurance premium ceded in the first layer, \$18,000,000 in the second layer, and \$15,000,000 in the third layer.

Healthcare/Physician Excess of Loss95% Authorized5% Unauthorized

\$4,000,000 excess of \$1,000,000 ultimate net loss, each policy or coverage, each insured, each occurrence or claim made.

Healthcare Hospital ProfessionalLiability Excess of Loss97.5% Authorized2.5% Unauthorized

\$10,000,000 excess of \$1,000,000 ultimate net loss, each policy or coverage, each insured, each occurrence or claim made, in excess of underlying insurance or self-insured retention.

Notwithstanding the above, with regard to the first five policies written or renewed with limits in excess of \$10,000,000, the reinsurer shall be liable for \$15,000,000 excess of \$1,000,000 ultimate net loss, each policy or coverage, each insured, each occurrence or claim made, in excess of underlying insurance or self-insured retention.

Healthcare Professional Liability50% Quota Share90% Authorized10% Unauthorized

Part A – Physicians Business: 50% of \$5,000,000 each occurrence or claim made, each insured, each policy or coverage

Part B –Hospital/Ancillary Healthcare Business:

1) 50% of \$11,000,000 each occurrence or claim made, each insured, each policy or coverage.

2) 50% of \$15,000,000 each occurrence or claim made, each insured, each policy or coverage after the Company has written or renewed the first five policies with limits in excess of \$10,000,000.

Type of Treaty

Executive Liability  
72.5% Quota Share  
77.5% Authorized  
22.5% Unauthorized

Coverage

Covers business classified as primary and excess directors and officer's liability insurance and related coverage, including but not limited to employment practices liability, fiduciary liability and crime/fidelity.

A) Liability limited to 72.5% of \$10,000,000 any one coverage, insured or claim (or 72.5% of \$15,000,000 as respect to directors and officers insureds with at least \$5,000,000 of Side A directors and officer's liability).

B) For policies issued to a single insured – Publicly-Traded Insureds limited to 72.5% of \$10,000,000 (or 72.5% of \$15,000,000 as respect to directors and officers insureds with at least \$5,000,000 of Side A directors and officer's liability) any one claim. For Privately-held or not-for-profit insureds limited to 72.5% of \$15,000,000.

These limits do not apply to crime/fidelity coverage.

Contingency Excess of Loss (Two Layers)  
100% Authorized

Covers business classified as Occupational Benefit.

\$7,500,000 excess of \$2,500,000 each loss occurrence. The maximum recovery for any one claimant involved in a loss occurrence is limited to an Ultimate Net Loss of \$2,500,000 and \$6,000,000 for layers one and two, respectively. Aggregate liability for layers one and two respectively are \$7,000,000 and \$8,000,000.

Personal Umbrella  
37.5% Quota Share  
100% Authorized

Part A - Covers business classified as personal umbrella liability, excess personal umbrella liability, and comprehensive personal liability limited to 37.5% of \$5,000,000 of net loss on any one policy, any one occurrence.

Part B - Policies issues both a comprehensive personal liability and an umbrella policy to the same insured, the limit of liability is 37.5% \$6,000,000 of net loss any one policy any one occurrence.

Identity Recovery  
100% Quota Share  
100% Authorized

Covers identity recovery with an annual aggregate of \$25,000 each identity recovery insured.

Type of TreatyCoverage

Personal Article Floater and Personal  
Property Floater  
90% Quota Share  
100% Authorized

Covers business classified as all risks and inland marine business in respect of personal article floaters, personal property floaters, fine arts, and like policies written by Monarch E&S Insurance Services. Liability is ceded on a net basis.

The maximum limit of liability for any one item is 90% of \$1,000,000 and 90% of \$6,000,000 any one schedule.

Marine Energy Excess of Loss (3 Layers)  
First Layer  
90.5% Authorized  
9.5% Unauthorized

Provides coverage policies underwritten as Marine Energy, excluding Gulf of Mexico Windstorm only Policies.

\$19,250,000 excess of \$1,750,000 net loss, each and every loss.

Second Layer  
87.25% Authorized  
12.75% Unauthorized

Third Layer  
89% Authorized  
11% Unauthorized

Offshore Marine  
10% Quota Share  
100% Authorized

Covers business classified as offshore marine, including onshore property under the code Clearwater Marine Pontus.

The maximum limit of liability for the Gulf of Mexico windstorm is 10% of \$125,000,000 in the aggregate; the maximum limit of liability from all loss occurrences is 10% of \$87,500,000.

Offshore Energy  
20% Quota Share  
100% Authorized

Covers business classified as Offshore Energy, including incidental Onshore Energy property.

The maximum limit of liability for the Gulf of Mexico windstorm is 20% of \$125,000,000 in the aggregate; and, for any loss occurrence resulting, directly or indirectly, from fire, explosion, control of wells and other allied perils is 20% of \$75,000,000. In addition, the maximum limit of liability from any one loss occurrence is 20% of \$87,000,000.

Reinsurance agreements with affiliates were reviewed for compliance with Article 15 of the New York Insurance Law. It was noted that all affiliated reinsurance agreements were filed with the Department pursuant to the provisions of Section 1505(d)(2) of the New York Insurance Law.

It is the Company's policy to obtain the appropriate collateral for its cessions to unauthorized reinsurers. Letters of credit and trust accounts obtained by the Company to take credit for cessions to unauthorized reinsurers were reviewed for compliance with Department Regulations 133 and 114, respectively. No exceptions were noted.

All ceded reinsurance agreements in effect as of the examination date were reviewed and found to contain the required clauses, including an insolvency clause meeting the requirements of Section 1308 of the New York Insurance Law.

Examination review of the Schedule F data reported by the Company in its filed annual statement was found to accurately reflect its reinsurance transactions. Additionally, management has represented that all material ceded reinsurance agreements transfer both underwriting and timing risk as set forth in SSAP No. 62, with the exception of a reinsurance agreement with United Medical Liability Insurance Company ("UMLIC"), which was determined not to transfer sufficient risk and is therefore accounted for and reported as a deposit in accordance with SSAP No. 75. Representations were supported by appropriate risk transfer analyses and an attestation from the Company's chief executive officer pursuant to the NAIC Annual Statement Instructions. Additionally, examination review indicated that the Company was not a party to any finite reinsurance agreements. All ceded reinsurance agreements, other than the UMLIC agreement noted above, were accounted for utilizing reinsurance accounting as set forth in SSAP No. 62.

During the period covered by this examination, the company did not commute any reinsurance agreements.

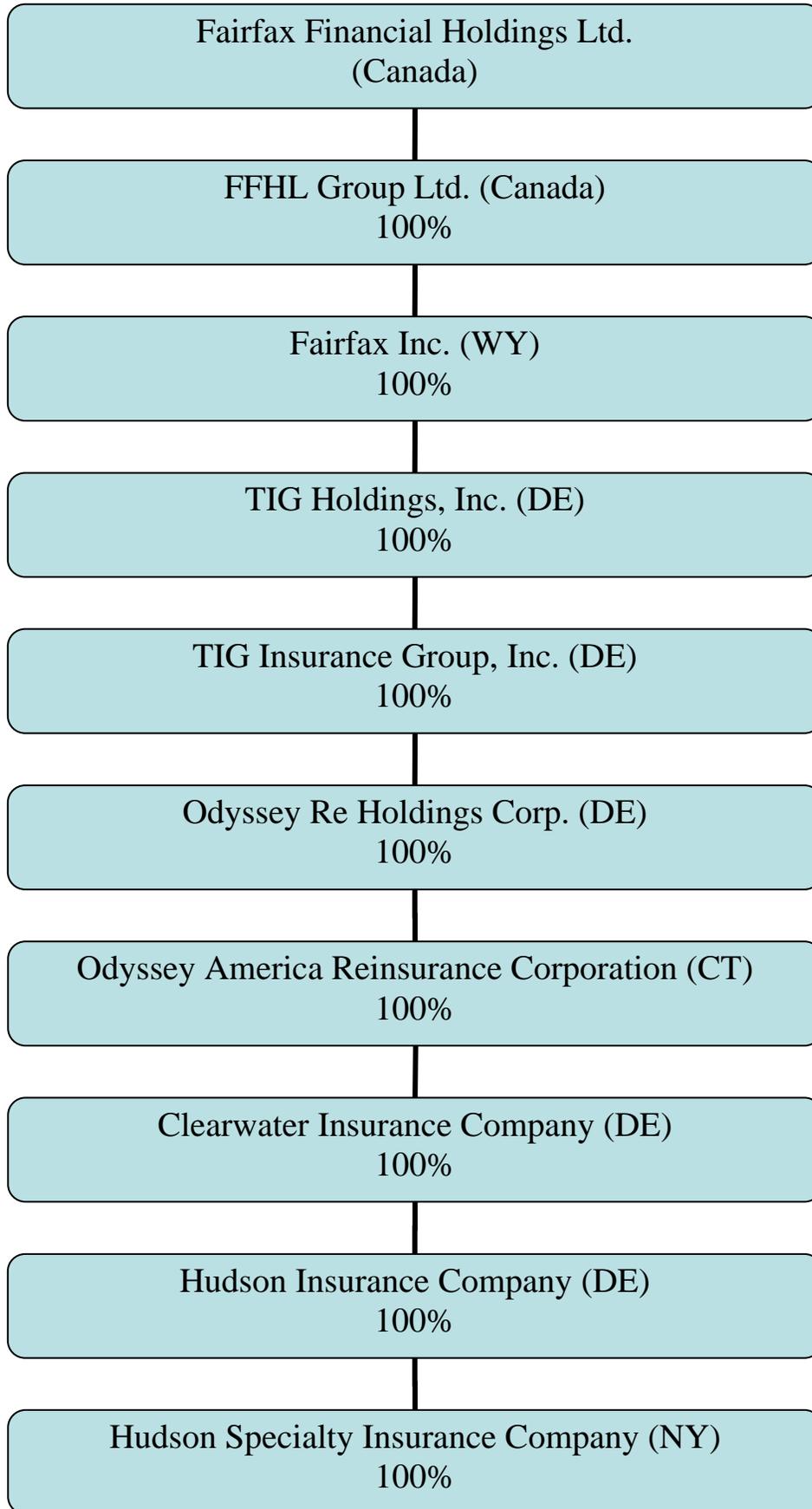
#### D. Holding Company System

The Company is a member of the Odyssey Reinsurance Group. The Company is 100% owned by Hudson Insurance Company, a Delaware domiciled company, which is ultimately controlled by Fairfax Financial Holding Ltd., a publicly traded Canadian financial service holding company.

Subsequent to the examination date, on January 1, 2011, Clearwater distributed, by means of a dividend, its ownership interest in the common stock of Hudson Insurance Company and Clearwater Select Insurance Company to Odyssey America. As a result, the Company is now an indirect wholly-owned subsidiary of Odyssey America. Additionally, Odyssey America distributed its ownership of Clearwater to Odyssey Re Holdings Corp. (“Holdings”), and Holdings, in turn, transferred ownership of Clearwater to TIG Insurance Group, Inc.

A review of the holding company registration statements filed with this Department indicated that such filings were complete and were filed in a timely manner pursuant to Article 15 of the New York Insurance Law and Department Regulation 52.

The following is an abridged chart of the holding company system at December 31, 2010:



At December 31, 2010, the Company was party to the following agreements with other members of its holding company system:

Investment Agreement

Effective October 28, 2003, the Company entered an investment agreement with its affiliates, Hamblin Watsa Investment Counsel Ltd., (“HW”) and Fairfax Financial Holdings Limited (“FFH”). The agreement authorizes HW and FFH jointly to manage and administer the Company’s investment accounts. This agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law.

Inter-Company Tax Allocation Agreement

Pursuant to a tax allocation agreement, the Company filed consolidated federal income tax returns with its parent, Odyssey Re Holdings Corp., and its affiliates from October 28, 2003 through October 31, 2009. This agreement has been filed with the Department pursuant to Section 1505 of the New York Insurance Law.

From November 1, 2009 to December 31, 2009 and in 2010, Odyssey Re Holdings Corp. and its subsidiaries were included in the consolidated federal income tax returns of its ultimate U.S. parent, Fairfax Inc.

Tax Service Agreement

Effective October 28, 2003, the Company entered a tax service agreement with Fairfax Inc., wherein Fairfax Inc. agrees to provide tax consulting and tax return preparation service to the Company. This agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law.

Expense Sharing Agreement

Effective October 28, 2003, the Company entered an expense sharing agreement with Odyssey America. Under the agreement, Odyssey America provides the Company office space and management services, including, but not limited to, underwriting, actuarial, claims, accounting, financial, legal, personnel, data processing service and treasury. The agreement was amended on

November 1, 2008. The agreement and the amended agreement were filed with the Department pursuant to Section 1505 of the New York Insurance Law.

Program Administrator Agreement

Effective January 1, 2007, the Company entered a program administrator agreement with Napa River Insurance Services, Inc (“NRIS”). Pursuant to the agreement, the Company appoints NRIS as its general agent, in the State of California, to underwrite, issue, and delivery insurance policies or contracts of business known by both parties as the California Healthcare Liability Program. This agreement was filed with the Department pursuant to Section 1505 of the New York Insurance Law.

E. Significant Operating Ratios

The following ratios have been computed as of December 31, 2010, based upon the results of this examination:

Net premiums written to surplus as regards policyholders	17%
Liabilities to liquid assets (cash and invested assets less investments in affiliates)	43%
Premiums in course of collection to surplus as regards policyholders	2%

All of the above ratios fall within the benchmark ranges set forth in the Insurance Regulatory Information System of the National Association of Insurance Commissioners.

The underwriting ratios presented below are on an earned/incurred basis and encompass the five-year period covered by this examination:

	<u>Amounts</u>	<u>Ratios</u>
Losses and loss adjustment expenses incurred	\$61,428,913	53.33%
Other underwriting expenses incurred	1,163,220	1.01
Net underwriting loss	<u>52,602,591</u>	<u>45.66</u>
Premiums earned	<u>\$115,194,724</u>	<u>100.00%</u>

F. Accounts and Records

(i) Agents' Balances

A review of the agents' balances' calculation revealed that the Company is not using policy effective date to calculate its non-admitted agents' balances for its program business, in accordance with SSAP No. 6, paragraph 7, which provides that:

“The due date for all premium balances is determined as follows: (a) Original and deposit premiums: governed by the effective date of the underlying insurance contract and not the agent/reporting entity contractual relationship; (b) Endorsement premiums: governed by the effective due date of the insurance policy endorsement; (c) Audit premium: governed by the insurance policy or insurance contract provisions. If the due date is not address by the insurance policy or insurance contract provisions, any uncollected premium (either accrual or billed) is non-admitted.”

The examiners' recalculation of the uncollected agents' receivables resulted in no material differences. Therefore, no examination change is warranted.

It is recommended that the Company adhere to SSAP No. 6 in determining its non-admitted agent's balance. It is noted that a similar recommendation was included in the prior report on examination.

It is also recommended that the Company establish an aging policy for program administrators to use policy effective date as due date to determine the non-admitted balance. It is noted that a similar recommendation was included in the prior report on examination.

### 3. FINANCIAL STATEMENTS

#### A Balance Sheet

The following shows the assets, liabilities and surplus as regards policyholders as of December 31, 2010 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	\$143,888,953	\$ 0	\$143,888,953
Preferred stocks	5,272,700	0	5,272,700
Common stocks	5,501,933	0	5,501,933
Cash, cash equivalents and short-term investments	18,162,097	0	18,162,097
Investment income due and accrued	2,288,778	0	2,288,778
Uncollected premiums and agents' balances in the course of collection	2,287,562	22,400	2,265,162
Deferred premiums, agents' balances and installments booked but deferred and not yet due	11,745,437	0	11,745,437
Amounts recoverable from reinsurers	8,950,403	0	8,950,403
Current federal and foreign income tax recoverable and interest thereon	2,360,062	0	2,360,062
Net deferred tax asset	5,287,963	2,345,754	2,942,209
Electronic data processing equipment and software	99,453	0	99,453
Furniture and equipment, including health care delivery assets	4,894	0	4,894
Receivables from parent, subsidiaries and affiliates	68,924	0	68,924
Loss clearing	12,649,867	0	12,649,867
Goodwill	5,186,346	5,186,346	0
Leasehold improvement	<u>6,986</u>	<u>0</u>	<u>6,986</u>
Total assets	<u>\$223,762,358</u>	<u>\$7,554,500</u>	<u>\$216,207,858</u>

Liabilities, Surplus and Other FundsLiabilities

Losses and loss adjustment expenses	\$46,196,527
Commissions payable, contingent commissions and other similar charges	(5,783,331)
Other expenses (excluding taxes, licenses and fees)	2,137,083
Taxes, licenses and fees (excluding federal and foreign income taxes)	17,448
Current federal and foreign income taxes	2,993,048
Unearned premiums	11,755,815
Ceded reinsurance premiums payable (net of ceding commissions)	23,812,658
Amounts withheld or retained by company for account of others	(42,098)
Provision for reinsurance	200,000
Payable to parent, subsidiaries and affiliates	33,426
STAT X/S Ceded Commission	2,464,243
UML LPT Reserve	<u>1,217,747</u>
 Total liabilities	 \$85,002,566

Surplus and Other Funds

Gains and Losses to Surplus – DTA 10R	\$1,352,409
Common capital stock	7,500,000
Gross paid in and contributed surplus	33,500,000
Unassigned funds (surplus)	<u>88,852,883</u>
 Surplus as regards policyholders	 <u>131,205,292</u>
 Total liabilities, surplus and other funds	 <u>\$216,207,858</u>

NOTE: The Internal Revenue Service has completed its audits of the Company's parent consolidated Federal Income Tax returns through tax year 2008. No material adjustments arose from said audits. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 2009 and 2010. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability was established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased \$64,251,428 during the five-year examination period January 1, 2006 through December 31, 2010, detailed as follows:

Underwriting Income

Premiums earned		\$115,194,724
Deductions:		
Losses and loss adjustment expenses incurred	\$61,428,913	
Other underwriting expenses incurred	<u>1,163,220</u>	
Total underwriting deductions		<u>62,592,133</u>
Net underwriting gain or (loss)		\$52,602,591

Investment Income

Net investment income earned	\$30,066,262	
Net realized capital gain	<u>8,865,640</u>	
Net investment gain or (loss)		38,931,902

Other Income

Aggregate write-ins for miscellaneous income	<u>\$ 211,428</u>	
Total other income		<u>211,428</u>
Net income after dividends to policyholders but before federal and foreign income taxes		\$91,745,921
Federal and foreign income taxes incurred		<u>26,751,027</u>
Net income		<u>\$64,994,894</u>

Surplus as regards policyholders per report on examination as of December 31, 2005			\$66,953,864
	<u>Gains in</u> <u>Surplus</u>	<u>Losses in</u> <u>Surplus</u>	
Net income	\$64,994,893		
Net unrealized capital gains or (losses)	1,636,175		
Change in net deferred income tax	4,770,218		
Change in nonadmitted assets		\$8,302,267	
Change in provision for reinsurance		200,000	
Aggregate write-ins for gains and losses in surplus	<u>1,352,409</u>	<u>0</u>	
Net increase (decrease) in surplus	<u>\$72,753,695</u>	<u>\$8,502,267</u>	<u>64,251,428</u>
Surplus as regards policyholders per report on examination as of December 31, 2010			<u>\$131,205,292</u>

#### 4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned items of \$46,196,527 is the same as reported by the Company as of December 31, 2010. The examination analysis was conducted in accordance with generally accepted actuarial principles and practices and was based on statistical information contained in the Company's internal records and in its filed annual statements.

A review of the Company's 2010 Schedule P revealed that it reported the earned premiums and losses incurred from extended reporting period (tail coverage) policies of medical malpractice and other liability lines of business in the "Claims-Made" sections of Schedule P. NAIC annual statement instructions require that earned premiums and losses incurred on tail policies be included in the "Occurrence" sections of the respective lines in Schedule P.

It is recommended that the Company adhere to NAIC annual statement instructions by reporting earned premiums and losses incurred from tail policies in the "Occurrence" sections of Schedule P for each respective line of business. It is noted that a similar recommendation was included in the prior report on examination.

## 5. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

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

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Reinsurance</u>	
i.     It was recommended that the Company correctly report the non-novated liabilities ceded to GSIC-AZ, pursuant to the provisions of paragraphs 30(d) and 26 of SSAP 62.	7
The Company has complied with this recommendation.	
ii.    It was recommended that the Company cede its business to the reinsurer in accordance with the terms in the filed reinsurance agreement.	8
The Company has complied with this recommendation.	
B. <u>Holding Company System</u>	
i.     It was recommended that the Company ensure that the parent company establishes an escrow account for the excess tax amount paid by the Company in accordance with Department Circular Letter No. 33 (1979).	10
The Company has complied with this recommendation.	
ii.    It was recommended that the Company allocate its inter-company expenses per the filed expense sharing agreement and in accordance with Department Regulation 30.	10
The Company has complied with this recommendation.	
C. <u>Accounts and Records</u>	
i. <u>Investments</u>	
It was recommended that the Company limits its investments in any one institution to no more than ten percent of its admitted assets pursuant to the provisions of Section 1409 of the New York Insurance Law.	12
The Company has complied with this recommendation.	

<u>ITEM</u>	<u>PAGE NO.</u>
ii. <u>Unearned Premium Reserve</u>	
It was recommended that the Company calculate unearned premium reserves in accordance with the practices and procedures prescribed in SSAP No. 65.	12
The Company has complied with this recommendation.	
iii. <u>Agents' Balances</u>	
It was recommended that the Company adhere to SSAP No. 6 in determining its non-admitted agents' balance.	13
The Company has not complied with this recommendation. A similar comment is made in this report.	
iv. It was also recommended that the Company establish a system to enable it to maintain the agents' balance detail on policy by policy basis and establish an aging policy for program administrators to use policy effective date as due date to determine the non-admitted balance.	13
The Company complied with the first part of this recommendation. A similar comment for the second part is made in this report.	
v. <u>Ceding Commission</u>	
It was recommended that the Company establish a liability for the difference between the anticipated acquisition cost and the reinsurance commissions received in accordance with SSAP No. 62.	13
The Company has complied with this recommendation.	
D. <u>Losses and Loss Adjustment Expenses</u>	
It was recommended that the Company adhere to NAIC annual statement instructions by reporting earned premiums and losses incurred from tail policies in the "Occurrence" sections of Schedule P for each respective line of business.	18
The Company has not complied with this recommendation. A similar comment is made in this report.	

6. **SUMMARY OF COMMENTS AND RECOMMENDATIONS**

<u>ITEM</u>	<u>PAGE NO.</u>
A. <u>Management</u>	
It is recommended that the Company convene regularly scheduled quarterly meetings of its board of directors as stated in its by-laws and maintain complete minutes of such proceedings.	5
B. <u>Accounts and Records</u>	
<u>Agents' Balances</u>	
i. It is recommended that the Company adhere to SSAP No. 6 in determining its non-admitted agent's balance.	16
ii. It is also recommended that the Company establish an aging policy for program administrators to use policy effective date as due date to determine the non-admitted balance.	16
C. <u>Losses and Loss Adjustment Expenses</u>	
It is recommended that the Company adhere to NAIC annual statement instructions by reporting earned premiums and losses incurred from tail policies in the "Occurrence" sections of Schedule P for each respective line of business.	20

Respectfully submitted,

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Maribel C. Nuñez, C.P.C.U  
Senior Insurance Examiner

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

MARIIBEL C. NUNEZ, 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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Maribel C. Nuñez

Subscribed and sworn to before me

this \_\_\_\_\_ day of \_\_\_\_\_, 2011.

Appointment No. 30623

STATE OF NEW YORK  
INSURANCE DEPARTMENT

I, James J. Wrynn Superintendent of Insurance of the State of New York,  
pursuant to the provisions of the Insurance Law, do hereby appoint:

**Maribel Nunez**

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

**HUDSON SPECIALTY INSURANCE COMPANY**

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

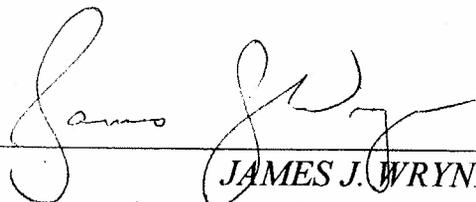
**Company**

*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 4th day of January, 2011*



  
\_\_\_\_\_  
JAMES J. WRYNN  
Superintendent of Insurance