# REPORT ON EXAMINATION

OF

GERLING AMERICA INSURANCE COMPANY

AS OF

DECEMBER 31, 2002

| | |
|---|---|
| DATE OF REPORT | NOVEMBER 1, 2005 |
| EXAMINER | JOSEPH ROME, CFE |

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STATE OF NEW YORK
INSURANCE DEPARTMENT
25 Beaver Street
New York, New York 10004

November 1, 2005

Honorable Howard Mills
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 22046 dated April 28, 2003, attached hereto, I have made an examination into the condition and affairs of the Gerling America Insurance Company as of December 31, 2002, and submit the following report thereon.

Wherever the designations "the Company" or "GAIC" appear herein without qualification, they should be understood to indicate Gerling America Insurance Company.

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

The examination was conducted at the Company's home office located at 717 5th Avenue, New York, New York 10022.

## 1. SCOPE OF EXAMINATION

The previous examination was conducted as of December 31, 1998. This examination covered the four-year period from January 1, 1999, through December 31, 2002. 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, 2002. 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 (“NAIC”):

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
Loss experience
Reinsurance
Accounts and records
Financial statements

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 was incorporated under the laws of the State of New York on March 4, 1981 and commenced business on June 24, 1982. Prior to December 30, 1994, 99% of the common stock of the Company was owned by Gerling Global Reinsurance Corporation – United States Branch and 1% owned by Gerling Security Corporation AG (Switzerland). On December 30, 1994, all common stock held by the United States Branch were sold to Gerling-Konzern Allgemeine Versicherungs AG ("GKA"), an affiliate located in Cologne, Germany. On June 30, 1995, Gerling Security Corporation sold its 1% share to GKA.

On November 30, 2000, the ownership of the Company was transferred from GKA to Gerling NAFTA General Holding, Inc. ("GNGH"). GNGH is a wholly-owned subsidiary of GKA.

Capital paid in is $5,000,000 consisting of 100 shares of $50,000 par value per share common stock. The Company did not receive any capital contributions during the current examination period. At December 31, 2002, the gross paid in and contributed surplus amounted to $115,191,919.

A. Management

Pursuant to the Company's charter and by-laws, the management of the Company is vested in a board of directors consisting of not less than thirteen nor more than twenty-one members. The board met two times during each calendar year. As of December 31, 2002, the board of directors had thirteen members, which consisted of the following individuals:

| Name and Residence | Principal Business Affiliation |
|---|---|
| Richard M. Barrow<br>Baldwin, NY | Senior Vice President, Treasurer and Chief Financial Officer,<br>Gerling America Insurance Company |
| Larry A. Crotser<br>Westwood, NJ | Vice President,<br>Gerling America Insurance Company |
| Mark G. Davidowitz<br>Merrick, NY | Vice President and Controller,<br>Gerling America Insurance Company |

| Name and Residence | Principal Business Affiliation |
|---|---|
| Andreas H. Henke<br>Toronto, Canada | President and Chief Executive Officer<br>Gerling Canada Insurance Company,<br>Toronto, Canada |
| David F. Huebel<br>Toronto, Canada | Senior Vice President,<br>Gerling Canada Insurance Company,<br>Toronto, Canada |
| Bjorn Jansli<br>Bonn, Germany | Chairman,<br>Gerling-Konzern Allgemeine Versicherungs-AG<br>Cologne, Germany |
| Dr.Hermann Jorissen<br>Cologne, Germany | Member of the Executive Board,<br>Gerling-Konzern Allgemeine Versicherungs-AG<br>Cologne, Germany |
| Michael P. LaRocca<br>New York, NY | Vice President,<br>Gerling America Insurance Company |
| John H. Martin<br>Basking Ridge, NJ | Vice President,<br>Gerling America Insurance Company |
| Peter Q. Noack<br>West Harrison, NY | President and Chief Executive Officer,<br>Gerling America Insurance Company |
| Kevin M. Petrolino<br>Parsippany, NJ | Assistant Vice President,<br>Gerling America Insurance Company |
| Israel A. Silverman<br>Brooklyn, NY | Assistant Vice President,<br>Gerling America Insurance Company |
| John J. Thompson<br>Oak Park, CA | Assistant Vice President,<br>Gerling America Insurance Company |

A review of the minutes of the board of directors' meetings held during the examination period indicated that the meetings were generally well attended and each board member has an acceptable record of attendance.

At December 31, 2002, the principal officers of the Company were as follows:

| Name | Title |
|---|---|
| Bjorn Jansli | Chairman of the Board |
| Peter Q. Noack | President and Chief Executive Officer |
| Gina De Simone | Assistant Vice President and Corporate Secretary |
| Richard M. Barrow | Senior Vice President, Treasurer and Chief Financial Officer |
| Mark G. Davidowitz | Vice President and Controller |
| Larry Crotser | Vice President |
| Michael P. LaRocca | Vice President |
| John H. Martin | Vice President |

B. Territory and Plan of Operation

At December 31, 2002, the Company was licensed to transact business in the District of Columbia and all states except New Hampshire.

At December 31, 2002, 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:

| Paragraph | Kind of Insurance |
|---|---|
| 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 |
| 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 empowered to transact such workers' compensation insurance as may be incident to coverages 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 No. 803, 69 Cong. as amended; 33 USC Section 901 et seq. as amended).

The Company is also licensed to write special risk insurance pursuant to Article 63 of the New York Insurance Law.

On May 24, 1996, the Department authorized the Company, subject to statutory exception and charter exclusion, to reinsure risks of every kind or description, and to insure property or risks of every kind or description located or resident outside of the United States, its territories and possessions, as provided in Section 4102(c) 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, Gerling America Insurance Company is required to maintain a minimum surplus to policyholders in the amount of $35,000,000.

All of the Company's business is produced through brokers. The Company is primarily a casualty insurer, with approximately 64.5% of its gross writings in casualty, 31.0% in property and the remainder in ocean marine. The Company principally markets commercial lines to industrial United States subsidiaries of European companies.

For the years under examination, the Company reported the following distribution of net premiums written (in 000s):

| Description | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|
| Direct business | $115,071 | $82,948 | $84,540 | $65,001 |
| Reinsurance assumed | | | | |
| Assumed from affiliates | 1,815 | 1,832 | 2,027 | 127 |
| Assumed from non-affiliates | 8,371 | 7,554 | 4,973 | 1,925 |
| Total direct and assumed | $125,257 | $92,334 | $91,540 | $67,053 |
| Reinsurance ceded | | | | |
| Ceded to affiliates | $(31,688) | $(61,739) | $(72,615) | $(61,201) |
| Ceded to non-affiliates | (42,868) | (29,625) | (18,210) | (3,077) |
| Net premiums written | $50,701 | $ 970 | $ 715 | $ 2,775 |

C. Reinsurance

Assumed

The Company assumes a relatively minor volume of business as compared to its direct writings. In 2001, the Company entered into a retroactive reinsurance treaty under which GAIC assumed GKA's excess liability on losses incurred on or after January 1, 2001, on a calendar year basis, on all policies written by various overseas branch offices of GKA. The attachment point for reinsurance coverage on subject matter business related to each of these branch offices varies. This treaty was suspended effective January 1, 2002, with the approval of the Department. The assumed business from the GKA branch offices is subject to the 95% quota share treaty with GKA described in the "Ceded" sub-section of the "Reinsurance" section of this report. The assumed business from the various GKA branch offices that is ceded under the 95% quota share cession is recorded as retroactive reinsurance. Losses relating to the assumed and ceded treaties are settled on an incurred basis.

Ceded

The Schedule F data as contained in the Company's filed annual statements was found to accurately reflect its reinsurance transactions. The examiner reviewed all ceded reinsurance contracts at December 31, 2002. The contracts all contained the required standard clauses including insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

In 2002, the Company's ceded $64,278,307, or 95.9%, of its direct and assumed premiums. Of the 2002 ceded premiums, $3,077,059, or 4.8% was ceded to non-affiliates and $61,201,248, or 95.2%, was ceded to affiliates as follows:

| | |
|---|---|
| Gerling Konzern Allgemeine (Germany) | $59,031,000 |
| Gerling Global Reinsurance Corp. of America (New York) | 1,855,000 |
| Gerling Canada Insurance Company (Canada) | 315,000 |
| Total affiliates | $61,201,000 |

The premiums ceded to affiliate Gerling Konzern Allgemeine ("GKA"), an unauthorized alien reinsurer, was comprised of the following facultative and treaty business:

| | |
|---|---|
| Facultative Property/Casualty/Marine to GKA (Cologne) | $15,525,000 |
| Facultative Property/Casualty to GKA (London) | 2,536,000 |
| Facultative Property/Casualty to GKA (Zurich) | 22,309,000 |
| Other Property Treaty | 225,000 |
| 95% Quota Share, all lines | 18,436,000 |
| Total ceded to GKA | $59,031,000 |

The Company had various prospective and retroactive reinsurance treaties with GKA during the examination period. The transactions relating to prospective reinsurance treaties with GKA resulted in a net decrease in the underwriting loss of approximately $18,859,000 in 2002. The transactions relating to retroactive reinsurance treaties with GKA resulted in a separately reported "retroactive reinsurance gain" of $19,420,000 in 2002.

The following are some of the more significant prospective and retroactive reinsurance treaties with GKA:

Prospective 95% Quota Share

The Company entered into a 95% quota share treaty with GKA, applying to all policies written or renewed with effective dates of January 1, 2000 and subsequent.

Retroactive 1998 Adverse Loss Treaty

During 1998, the Company entered into an adverse loss treaty with GKA which covers all accident dates on or before December 31, 1998, for all casualty lines. The treaty covers 100% of the sum of losses occurring in 1998 and adverse loss development from 1997 reserves in excess of $118 million up to a limit of $100 million. During 1999, the Company entered into an agreement with GKA to extend the original $100 million limit by an additional $125 million for a new limit of $225 million in excess of $118 million. The treaty also covers (within the $225 million treaty limit) any underwriting loss to the Company as a result of a settlement (including, but not limited to, a final determination or commutation) of a reinsurance arrangement which involves casualty business subject to the treaty. Under the terms of this treaty, the Company paid a reinsurance premium of $10 million in 1998 for the original cover and an additional $10 million in 1999 for the extended limits. During 2000, the Company inserted between the two covers above, $125 million of coverage with Manufacturers Property & Casualty Limited ("Manufacturers"), a Barbados-domiciled, unaffiliated reinsurer. This new retroactive reinsurance treaty covers all accident dates on or before December 31, 1999, for casualty lines and covers 100% of payments after June 30, 2002, in excess of $91 million up to a limit of $125 million. In 2002, the Company recorded a net retroactive reinsurance gain relating to the original GKA treaty of $6,879,000. The Company recorded a net gain from the Manufacturers' treaty of $1,929,000 in 2002.

Effective September 30, 2004, the Company commuted the Manufacturers' treaty and recorded a loss on commutation of $1,722,000.

Effective October 1, 2003, the 1998 Adverse Loss Treaty was cancelled and replaced with a broader, retroactive treaty (see "Combined Cover")

Prospective 1999 Stop Loss Treaty and 2000 Retroactive Extension

In 1999, the Company entered into an accident year prospective stop loss treaty with GKA. Under the provisions of this treaty, GKA pays 94% of the net 1999 accident year losses incurred by the Company on all lines of business that exceed 85% of the 1999 net premiums earned by the Company to a maximum aggregate of $10 million. The Company paid $1 million for the cover in 1999 and ceded $10 million in losses in 1999. In 2000, the Company entered into a retroactive reinsurance treaty with GKA by extending the original 1999 limits of $10 million by an additional $40 million to a new maximum aggregate of $50 million. The Company paid an additional $5,837,000 for the extended cover in 2000. The Company recorded a net retroactive reinsurance gain from this treaty of $12,541,000 in 2002.

Effective October 1, 2003, the 1999 Stop Loss Treaty was cancelled and replaced with a broader, retroactive treaty (see "Combined Cover").

Prospective 2000 Stop Loss Treaty

In 2000, the Company entered into an accident year prospective stop loss treaty with GKA. Under the provisions of this treaty, GKA pays 94% of the net 2000 accident year losses incurred by the Company on all lines of business that exceed 85% of the 2000 net premiums earned by the Company on policies effective prior to January 1, 2000. The maximum aggregate recovery under this treaty is $50 million. The Company paid $1,250,000 for this cover in 2000. The Company ceded incurred losses under this cover of $6,104,000 in 2002.

Effective October 1, 2003, the 2000 Stop Loss Treaty was cancelled and replaced with a broader, retroactive treaty (see "Combined Cover").

Subsequent "Combined Cover"

Effective October 1, 2003, the Company consolidated the three existing treaties into one, broader, retroactive reinsurance cover ("Combined Cover"), covering all lines of business. The three treaties, which were consolidated are the 1998 Adverse Loss Treaty (covering 1998 and prior years casualty business), the 1999 Stop Loss Treaty (covering the 1999 accident year, all lines), and the 2000 Stop Loss Treaty (covering the 2000 accident year on policies issued prior to January 1, 2000, all lines). The reinsurer on all three contracts was the Company's parent company, GKA.

Unauthorized Reinsurance

The letters of credit obtained by the Company in order to take credit for cessions made to unauthorized reinsurers were reviewed for compliance with Department Regulations 114 and 133, respectively. No exceptions were noted.

D. Holding Company System

The Company is a member of the Gerling Group of Insurance Companies. The Company is a wholly owned subsidiary of Gerling NAFTA General Holding Inc., a Delaware corporation, which is ultimately owned by Gerling-Konzern Versicherungs Beteiligungs-Aktiensgesellschaft ("GKB"), a Cologne, Germany corporation. The group is comprised of a large number of related entities with ultimate control being held by a private group of Dr. Rolf Gerling.

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

The following is an abbreviated chart of the holding company system at December 31, 2002:

Deutsche Bank AG, Germany (34.5%)
Private Group of Dr. Rolf Gerling, Germany (65.5%)
- Gerling-Konzern Versicherungs-Beteiligungs-Aktiengesellschaft, Germany
  - Gerling-Konzern Global Ruckversicherrungs-Aktiengesellschaft, Germany (includes Gerling Global Reinsurance Corp. (U.S. Branch), New York (remaining subsidiaries not listed in this chart including GGRCA and CIC)
  - Gerling Beteiligungs GmbH, Germany(owns direct business writers)
    - Gerling NCM Credit and Finance, Germany (51%)
      - (not listed are the subsidiaries of Gerling NCM)
    - Gerling-Konzern Lebensversicherunhgs, Germany (95%)
      - Global Krankenversicherungs-AG, Germany (45%)
    - Gerling-Konzern Allgemeine Versicherungs-AG, Germany(89.5%)
      - Gerling Corporate Limited, Great Britain
      - Gerling Polska towarzyswo Ubezpieczen S.A., Poland
      - Gerling General Insurance of South Africa, Ltd, South Africa
      - Gerling Welt Service GmbH, Germany
        - Gerling Australia Ins. Co. Pty. Ltd, Australia
        - Gerling Slovensko AS, Bratislava , Slovak, Republic
        - Gerling Sul America S.A. Sequros Industrias, Brazil (50%)
        - Gerling NAFTA General Holding Inc., Delaware
          - Gerling Insurance Agency, Inc. New York
          - Gerling Canada Insurance Company, Canada
          - Gerling America Insurance Company, New York
            - Gerling de Mexico Seguros S.A., Mexico

At December 31, 2002, the Company was party to the following agreements with other members of the holding company system:

<u>Expense Sharing Service Agreement</u>

On January 1, 1999, the prior management company’s employees were transferred to GAIC. The Company is a party to an agreement dated January 5, 2002, between Gerling Global US Investments, Inc.(“GGUSI”), a New York corporation, and Gerling Global Reinsurance Corporation of America, a New York insurance corporation, as providers to Gerling America Insurance Company and other affiliate companies.

The function of this agreement is to make available to each affiliate facilities and its participation in the retirement plan of GGUSI and share payroll function. Otherwise, all other services are provided from within the Company and its employees.

The above referenced agreement was found to have been filed with the Department pursuant to Section 1505 of the New York Insurance Law.

## 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 comptroller 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's abandoned property reports for the period of this examination were all filed on a timely basis pursuant to the provisions of Section 1316 of the New York Abandoned Property Law.

## F. Significant Operating Ratio

The following ratios have been computed as of December 31, 2002 based upon the results of this examination:

| | |
|---|---|
| Net premiums written in 2002 to surplus as regards policyholders | 0.5 to 1 |
| Liabilities to Liquid assets (cash and invested assets less investments in affiliates) | 85.3% |
| Premiums in course of collection to surplus as regards policyholders | 0.8% |

All of the above ratios are within the benchmark range for that ratio as 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 four-year period covered by this examination:

| | Amounts | Ratios |
|---|---|---|
| Losses and loss adjustment expenses | $ 152,374,367 | 184.6% |
| Other underwriting expenses | 24,420,016 | 29.6 |
| Net underwriting loss | (94,243,125) | (114.2) |
| Premiums | $82,551,258 | 100.0% |

G. Accounts and Records

During the period under examination, it was noted that the Company's treatment of the following items was not in accordance with generally accepted statutory accounting principles and/or Department guidelines:

Internal Controls – EDP Systems

A review of the Company's information system controls revealed weaknesses in various areas. A summary of the recommendations noted follows:

- That the Company formally document the results of the meetings held with senior management regarding the Information Technology ("IT") function.
- That the Company should document long range and short range plans consistent with the Company's broader plans for attaining the organization's goals.
- That the Company develop and maintain job descriptions for its Information System ("IS") staff.
- That the Company ensure that all requests for changes and system maintenance are standardized and are subject for formal change management procedures.
- That the Company ensure application and technical documentation is updated to reflect changes implemented.
- That the Company prepare reports of system availability and downtime, number and percentage of job failures and reruns, and IS service level to users and these reports be reviewed by management.
- That the Company create a comprehensive security policy.
- That the Company establish a policy to standardize system password parameters across all platforms and applications.

- That the Company maintain an accurate and comprehensive record of all systems users' access capabilities and authorization of the specified level of access.

- That management perform a periodic review of user access capabilities to ensure that access is commensurate with each user's job responsibilities.

- That the Company update its disaster recovery and business continuity plan to reflect the recent changes that have taken place at the Company and to incorporate a restoration priority; the specific steps for the recovery of applications and systems; and the manual processing procedures to be used until the electronic data processing function can be restored in the event of a disaster.

- That the Company prepare and enforce a periodic maintenance schedule of computer work to be accomplished within a specific timeframe.

- That the Company develop a documentation check-off list to ensure that all required documentation is prepared and approved for all new systems and for changes to existing systems and/or programs.

It is recommended that the Company take appropriate action to implement corrective action for its IT environment as noted in the above recommendations.

## 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, 2002 and as reported by the Company:

| | Examination | | | Company | |
|---|---|---|---|---|---|
| Assets | Ledger Assets | Assets Not Admitted | Net Admitted Assets | Net Admitted Assets | Surplus Increase (Decrease) |
| Bonds | $ 90,980,344 | $ | $ 90,980,344 | $ 90,980,344 | $ |
| Preferred stocks | 4,358,750 | | 4,358,750 | 4,358,750 | |
| Common stocks | 4,465,941 | | 4,465,941 | 4,465,941 | |
| Cash and short-term investments | 73,238,471 | | 73,238,471 | 73,238,471 | |
| Other invested assets | 1,501,954 | | 1,501,954 | 1,501,954 | |
| Receivable for securities | 20,313 | | 20,313 | 20,313 | |
| Premiums and agents' balances in course of collection | 666,609 | 171,293 | 495,316 | 495,316 | |
| Premiums, agents' balances and installments booked but deferred and not yet due | 662,163 | | 662,163 | 662,163 | |
| Funds held by or deposited with reinsurance companies | 245,290 | | 245,290 | 245,290 | |
| Reinsurance recoverable on loss and loss adjustment expenses | 23,805,685 | | 23,805,685 | 23,805,685 | |
| Interest, dividends and real estate income due and accrued | 1,011,120 | | 1,011,120 | 1,011,120 | |
| Receivables from parent, subsidiaries and affiliates | 50,419 | | 50,419 | 50,419 | |
| Aggregate write-ins for other than invested assets | 1,156,212 | | 1,156,212 | 1,156,212 | |
| Total assets | $202,163,271 | $ 171,293 | $201,991,978 | $201,991,978 | $ 0 |

| Liabilities, Surplus and Other Funds | | | Surplus |
|---|---|---|---|
| Liabilities | Examination | Company | Increase (Decrease) |
| Losses and loss adjustment expenses | $ 176,368,544 | $ 134,132,544 | $ (42,236,000) |
| Other expenses | 3,031,878 | 3,031,878 | |
| Taxes, licenses and fees | 365,000 | 365,000 | |
| Unearned premiums | 653,653 | 653,653 | |
| Ceded reinsurance premiums payable | 4,625,438 | 4,625,438 | |
| Funds held by company under reinsurance treaties | 1,457,589 | 1,457,589 | |
| Amounts withheld or retained by company for account of others | 3,127,737 | 3,127,737 | |
| Provision for reinsurance | 9,866,246 | 9,866,246 | |
| Retroactive reinsurance recoverables | (128,488,000) | (107,020,000) | 21,468,000 |
| Loss Clearing Account | 142,817 | 142,817 | |
| Funds held on retroactive reinsurance treaty | 77,528,352 | 77,528,352 | |
| Total liabilities | $ 148,679,254 | $ 127,911,254 | $(20,768,000) |
| Surplus and Other Funds | | | |
| Special surplus from retroactive reinsurance account | $ 128,488,000 | $ 107,020,000 | $ 21,468,000 |
| Common capital stock | 5,000,000 | 5,000,000 | |
| Gross paid in and contributed surplus | 115,191,919 | 115,191,919 | |
| Unassigned funds | (195,367,195) | (153,131,195) | (42,236,000) |
| Surplus as regards policyholders | $ 53,312,724 | $ 74,080,724 | $(20,768,000) |
| Total liabilities and surplus and other funds | $ 201,991,978 | $ 201,991,978 | |

NOTE: The Internal Revenue Service has not audited any of the Company's financial statements for the current period under examination. Except for any impact that might result from the examination changes contained in this report, the examiner is unaware of any potential exposure of the Company to any further tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased $110,017,290 during the four year examination period from January 1, 1999 through December 31, 2002, detailed as follows:

## Statement of Income

| | | |
|---|---|---|
| Underwriting Income | | |
| Premiums earned | | $ 82,551,258 |
| Deductions: | | |
| Losses and loss expenses incurred | $ 152,374,367 | |
| Other underwriting expenses incurred | 24,420,016 | |
| Total underwriting deductions | | 176,794,383 |
| Net underwriting gain or (loss) | | $(94,243,125) |
| Investment Income | | |
| Net investment income earned | $ 50,079,634 | |
| Net realized capital gains | 4,639,019 | |
| Net investment gain | | 54,718,653 |
| Other income | | |
| Net loss from agents' or premiums balances charged off | $ (273,470) | |
| Aggregate write-in-miscellaneous | 3,153,515 | |
| Aggregate write-in-retroactive reinsurance | 145,106,531 | |
| Total other income | | 147,986,576 |
| Net income before federal and foreign income taxes | | 108,462,104 |
| Federal and foreign income taxes incurred | | 0 |
| Net income (Loss) | | $108,462,104 |

C. Capital and Surplus Account

| | Increases in Surplus | Decreases in Surplus | |
|---|---|---|---|
| Surplus as regards policyholders, per report on examination as of December 31, 1998 | | | $ (56,704,566) |
| Net income | $ 108,462,104 | | |
| Net unrealized capital loss | | $ 6,493,928 | |
| Change in non-admitted assets | 8,047,605 | | |
| Change in provision for reinsurance | 1,614,933 | | |
| Cumulative effect of changes in accounting | | 1,613,424 | |
| Total gains and losses | $ 118,124,642 | $ 8,107,352 | |
| Net increase in surplus | | | 110,,017,290 |
| Surplus as regards policyholders, per report on examination as of December 31, 2002 | | | $53,312,724 |

## 4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liability for the captioned liability of $176,368,544 is $42,236,000 more than the $134,132,544 reported by the Company as of December 31, 2002.

The examination analysis of the loss and loss adjustment expenses 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.

## 5. RETROACTIVE REINSURANCE RECOVERABLES

The examination contra liability for the captioned item of $128,488,000 is $21,468,000 more than the $107,020,000 reported by the Company in its December 31, 2002 filed annual statement. This examination change reflects amount of the examination increase in loss and loss adjustment expense reserves that is recoverable from the Company's retroactive reinsurance treaties. The examination increase to loss and loss adjustment expense reserves is reported in section 4 herein. The Company has subsequently acquired adequate collateral from GKA to allow credit in accordance with Department Regulation 108.

## 6. AGGREGATE WRITE-INS FOR SPECIAL SURPLUS FUNDS

The examination amount for the captioned special surplus item of $(128,488,000) is $(21,468,000) more than the $(107,020,000) reported by the Company in its December 31, 2002 filed annual statement.

The adjustment is the result of the examinations increase to loss and loss adjustment expense reserves which are ceded to the Company's retroactive reinsurance contracts (see section 2C).

## 7. MARKET CONDUCT ACTIVITIES

In the course of this examination, a review was made of the manner in which the Company conducts its business practices and fulfills its contractual obligations to policyholders and claimants. The review was general in nature and is not to be construed as 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 the Company's claims and complaint handling practices. No problem areas were encountered.

## 8. COMPLIANCE WITH PRIOR REPORT OF EXAMINATION

The prior report on examination contained five comments and recommendations, which the Company has acted upon as follows (page numbers refer to the prior report):

| ITEM | | PAGE NO. |
|---|---|---|
| A. | Insolvency | |
| | The Company is insolvent in the amount of $56,704,566 and its minimum required surplus to policyholders of $35,000,000 is impaired in the amount of $91,704,566. | 1 |
| | Subsequent corrective actions taken by management eliminated this insolvency. The recommendation is no longer applicable. | |
| B. | Management | |
| | It is recommended that the Company endeavor to ensure that all directors, officers and key employees complete conflict of interest statements on a yearly basis. | 5 |
| | The Company has complied with this recommendation. | |
| C. | Compliance with Regulation 118 | |
| | It is recommended that the Company obtain on a yearly basis a written contract from its independent certified public accountant that conforms to the requirements of Section 307(b) of the New York Insurance Law and with the provisions of Part 89.2 of Department Regulation 118. | 17 |
| | The Company has complied with this recommendation. | |
| D. | Abandoned Property Law | |
| | It is recommended that GAIC comply with Section 1316 of the New York Abandoned Property Law and file on a yearly basis the requisite abandoned property reports with the Office of the New York State Comptroller. | 17 |
| | The Company has complied with this recommendation. | |
| E. | Retroactive Reinsurance | |
| | It is recommended that GAIC comply with the requirements set forth in Section 112.5(j) of Department Regulation 108 and obtain from its parent, GKA, appropriate funding for its retrospective coverage. | 25 |
| | The Company has complied with this recommendation. | |

## 9. SUMMARY OF COMMENTS AND RECOMMENDATIONS

The current report comments and recommendations are summarized as follows:

| ITEM | | PAGE NO. |
|---|---|---|
| A. | Accounts and Records | |
| i. | Information Systems Controls | |
| | It is recommended that the Company take appropriate action to implement corrective action regarding its IT system controls as noted in this report. | 14 |

Respectfully submitted,

__________/S/_________
Joesph A. Rome, CFE
Examiner-in-Charge

STATE OF NEW YORK )
) SS.
)
COUNTY OF NEW YORK)

JOSEPH ROME, being duly sworn, deposes and says that the foregoing report submitted to by him is true to the best of his knowledge and belief.

________/S/___________
Joesph A. Rome, CFE

Subscribed and sworn to before me

this________day of ________________2005.

*Appointment No* 22046

*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:*

**Joseph Rome**

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

**GERLING AMERICA INSURANCE COMPANY**

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

**Company**

*with such other information as he 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* 28th day *of* April, 2003

*GREGORY V. SERIO*
*Superintendent of Insurance*