REPORT ON EXAMINATION

OF THE

NAVIGATORS INSURANCE COMPANY

AS OF

DECEMBER 31, 2000

DATE OF REPORT	JULY 1, 2003
EXAMINER	ERWIN ROCA

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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

July 1, 2003

Honorable Gregory 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 21803 dated November 27, 2001, attached hereto, I have made an examination into the financial condition and affairs of Navigators Insurance Company as of December 31, 2000. The following report is hereby submitted.

The examination was conducted at the Company's home office located at One Penn Plaza, New York, New York 10119-0002.

Where the designations "Company" and "Navigators" appear herein without qualification, they should be understood to indicate the Navigators Insurance Company.

Where the designation "the Department" appears herein without qualification, it should be understood to indicate the New York Insurance Department.

1. SCOPE OF EXAMINATION

The previous examination of the Company was conducted as of December 31, 1995. This examination covers the five-year period from January 1, 1996 through December 31, 2000. Transactions 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, 2000, a review of income and disbursements deemed necessary to accomplish such verification and utilized, to the extent considered appropriate, work performed by the Company's independent certified 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
Market conduct activities
Growth of Company
Business in force by states
Reinsurance
Accounts and records
Financial statements

A review was made to ascertain what action was taken by the Company with regard to the 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 July 16, 1981. Active underwriting operations began on April 1, 1983.

Capital paid-in is $5,000,000, consisting of 100 shares of common stock $50,000 par value per share and its gross paid-in and contributed surplus is $46,122,108. All of the outstanding capital stock of the Company is owned by the Navigators Group, Inc., a publicly traded company, which is in turn 51% owned by Terence N. Deeks and family.

A. Management

Pursuant to the Company's charter and by-laws, corporate powers shall be exercised by a board of directors consisting of not less than thirteen nor more than twenty-one members. As of December 31, 2000, the board of directors was comprised of the following thirteen members:

Name and Residence	Principal Business Affiliation
Michael L. Civisca New City, NY	Vice President, Somerset Marine, Inc.
John A. Cooper Kent, UK	Managing Director, Mander, Thomas & Cooper
Brian R. Deans Berkeley, CA	President, SIS of California, Inc.

Name and Residence	Principal Business Affiliation
Terence N. Deeks Summit, NJ	Chairman, President and Chief Executive Officer, Navigators Insurance Company and NIC Insurance Company

Richard S. Eisdorfer Trumbell, CT	Senior Vice President, Navigators Insurance Company and NIC Insurance Company
Noel Higgitt Menlo Park, CA	President, Anfield Insurance Services, Inc.
Christopher A. Johnson Martinez, CA	Vice President, SIS of California, Inc.
Russel J. Johnson Seaford, NY	Senior Vice President, Somerset Marine, Inc.
John W. Jones Kingwood, TX	President, SIS of Texas, Inc.
Salvatore A. Margarella Staten Island, NY	Vice President and Treasurer, Navigators Insurance Company and NIC Insurance Company
James V. McGuire Essex Falls, NJ	Senior Vice President, Somerset Marine, Inc.
Gregory D. Olson Seattle, WA	President, SIS of Washington, Inc.
Bradley D. Wiley Ringwood, NJ	Senior Vice President, Chief Financial Officer and Secretary, Navigators Insurance Company NIC Insurance Company

The board met four times during each calendar year under examination. The minutes of all meetings of the board of directors held during the examination period were reviewed. The meetings were generally well attended and each of the directors had a satisfactory attendance record.

The principal officers of the Company as of December 31, 2000 were as follows:

Name	Title
Terence N. Deeks	Chairman of the Board, President and Chief Executive Officer
Richard S. Eisdorfer	Senior Vice President
Bradley D. Wiley	Senior Vice President, Chief Financial Officer and

	Secretary
Salvatore Margarella	Vice President and Treasurer

B. Territory and Plan of Operation

As of the examination date, the Company was licensed in the District of Columbia, Puerto Rico, the U. S. Virgin Islands, Venezuela and all states. In addition, the Company is licensed in the United Kingdom where the Company operates a branch.

The following schedule shows direct premiums written in New York State compared to direct business written in the United States for the five years covered by this examination:

Direct Premiums Written

Calendar Year	New York State	Total United States	Percentage of New York State
1996	$7,514,001	$62,826,014	11.96%
1997	$8,847,139	$58,848,494	15.03%
1998	$176,328	$40,120,789	0.44%
1999	$1,667,070	$41,015,296	4.06%
2000	$536,873	$45,089,979	1.19%

During the period under examination, the Company wrote direct business for risks located outside of the United States as follows:

Calendar Year	Premiums on Risks Located Outside of the United States	Total Premiums Written	Percentage of Premiums written outside of the United States

1996	$25,726,299	$88,552,313	29.05%
1997	$34,311,355	$93,159,849	36.83%
1998	$29,669,657	$69,790,446	42.51%
1999	$39,210,637	$80,225,933	48.88%
2000	$48,629,262	$93,719,241	51.89%

The NAIC instructions to the annual statements for Schedule T, requires that the Company list separately each alien jurisdiction for which there is no pre-printed line on Schedule T. During the period under examination the Company did not comply with this instruction.

It is recommended that the Company comply with the NAIC instructions to the annual statements and list in Schedule T each alien jurisdiction.

As of December 31, 2000, 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
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
Paragraph	Kind of Insurance
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), including insurances described in the Longshoremen's and Harbor Workers' Compensation Act (Public Law No. 803, 69 Congress as amended; 33 USC Section 901 et seq. as amended) and the kinds of insurance and reinsurance as defined in paragraph (c) of Section 4102 of the New York Insurance Law. The Company is also 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, Navigators Insurance Company is required to maintain a minimum surplus to policyholders in the amount of $35,000,000.

The Company writes business worldwide and its direct business is produced by various affiliated underwriting agencies. In calendar year 2000, approximately 60% of the Company's business was marine business and was produced by six affiliated underwriting agencies, collectively known as the "Somerset Agencies". The Company's non-marine business is produced by Anfield Insurance Services, also an affiliated underwriting agency.

The Somerset Agencies produce business for the Company and four unaffiliated insurers. This business is then pooled between the companies pursuant to management agreements between the Somerset Agencies and each of the insurers (as more fully described in Item 2C of this report), with Navigators receiving 75% of all of the pooled business. Additionally, the Company assumes 100% of the gross direct written premiums written by its affiliate, NIC Insurance Company ("NIC"). For the year ended December 31, 2000, the business assumed from NIC amounted to approximately $4.2 million and represented less than 3.8% of the Company gross written premiums.

C. Reinsurance

1. Assumed Reinsurance

Assumed reinsurance accounted for 15.5% of the Company's gross premium writings in calendar year 2000. The Company assumes business primarily from two sources: (1) an internal pool with its affiliate, NIC Insurance Company; and (2) a participation in what is referred to herein as the "Somerset Pools".

a) Internal Pool

Effective January 1, 1999, the Company assumes 100% of the business written by NIC Insurance Company ("NIC") pursuant to a reinsurance agreement. Prior to January 1, 1999, NIC (formerly Pilot Insurance Company) and Navigators were party to a pooling agreement whereby the Company assumed 100% of its business written or assumed by NIC. Navigators, in turn, ceded 10% of its net business (including the business it assumed from NIC) to NIC. Concurrent with the effective date of the reinsurance agreement, NIC terminated the reinsurance agreement in effect at December 31, 1998, and transferred all of its outstanding losses, loss adjustment expenses and unearned premiums as of December 31, 1998 to the Company, pursuant to a commutation agreement, which was approved by this Department.

b) Somerset Pools

The Somerset Agencies produce, manage and underwrite business for the Company and four unaffiliated insurers pursuant to various management agreements. All business produced for these insurers by the Somerset Agencies is pooled, with Navigators receiving 75% of the pooled business. Each policy is written in the name of one of the insurers and each insurer retains a portion of each risk equal to its participation percentage. The remaining risk is then allocated to the other pool participants based on the underwriting limitations set forth in the management agreements. The "Somerset Pool" business accounted for the majority of the Company's gross written premiums in the year 2000.

2. Ceded Reinsurance

The Schedule F data as contained in the Company's annual statements filed for the years within the examination period was found to accurately reflect its reinsurance transactions.

All ceded reinsurance contracts effected during the examination period were reviewed and all were found to contain the required standard clauses including insolvency clauses meeting the requirements of Section 1308 of the New York Insurance Law.

Reinsurance protection was obtained by the Somerset Agencies for the benefit of all of the pool participants. The following ceded reinsurance program was in effect for the benefit of all the pool members as of December 31, 2000:

Type of Contracts	Limits and Retention
Ocean Marine Proportional Reinsurance	
Bluewater Hull Coverage 36% authorized 64% unauthorized	20.8% quota share on all policies, subject to a maximum limit of $5,625,000, any one unit and/or risk.

Type of Contracts	Limits and Retention
Cargo and Specific Coverage 60% authorized 40% unauthorized	42.4% quota share on all policies, subject to a maximum limit of $22,500,000, any one risk, any one vessel, conveyance or aircraft

	or any one cover, contract or policy.
Craft Coverage. 58% authorized 42% unauthorized	90% quota share on all policies subject to a maximum limit of $3,750,000 any one risk and/or interest.
Transport Coverage 32% authorized 68% unauthorized	80% quota share on all policies subject to a maximum limit of $3,750,000 each interest, not exceeding $7,500,000 combined singe limit.
Marine War Coverage 97.50% authorized 02.50% unauthorized	100% quota share on all policies subject to a maximum limit of $22,500,000 each and every risk.
Marine Liability Coverage 91% authorized 9% unauthorized	90% quota share on all policies subject to a maximum limit of $2,250,000 any one risk and/or interest.
Offshore Energy Coverage 43% authorized 57% unauthorized	30% quota share on all policies subject to a maximum limit of $26,250,000 combined single limit any one unit, or per occurrence any one insured.
Ocean Marine Excess of Loss Reinsurance:	
Liability Specific Coverage 65% authorized 35% unauthorized	$1,875,000 excess of $375,000, ultimate net loss, each and every risk and/or occurrence or series of losses or occurrences arising from one event.
Whole Account Excluding Liability Written Coverage 78% authorized 22% unauthorized	$1,875,000 excess of $375,000 ultimate net loss each and every risk and/or occurrence or series of losses or occurrences arising from one event.
Type of Contracts	Limits and Retention
Whole Account Coverage 60% authorized 40% unauthorized	$3,750,000 excess of $2,250,000 ultimate net loss each and every risk and/or occurrence or

	series of losses or occurrences arising from one event.
<u>Whole Account Coverage</u> 83% authorized 17% unauthorized	$1,875,000 excess of $1,125,000 ultimate net loss each and every loss and/or occurrence or series of losses or occurrences arising from one event.
<u>Hull Account Coverage</u> 33.66% authorized 66.34% unauthorized	$1,500,000 excess of $1,500,000 ultimate net loss each and every loss and/or occurrence or series of losses or occurrences arising from one event.
<u>Hull Account Coverage</u> 33.66% authorized 66.34% unauthorized	$2,625,000 excess of $3,000,000 ultimate net loss each and every loss and/or occurrence or series of losses or occurrences arising from one event.
<u>Whole Account Coverage</u> 75% authorized 25% unauthorized 6 layers	$22,500,000 excess of $375,000 ultimate net loss each and every risk and/or occurrence or series of losses or occurrences arising from one event. Layers 1 through 6 covers Cargo, Bluewater Hull, Energy, Craft, Liability and Transport.
<u>Reinstatement Premium Protection Coverage</u> 77.50% authorized 22.50% unauthorized	All reinstatement premiums payable in respect of each layer.

In addition to the above treaties, the Company has in place additional marine covers that provide benefits in the event that the reinstatements on the original covers are exhausted. These treaties require that an aggregate limit for all of the pool members be incurred before coverage is triggered.

<u>Type of Contracts</u>	<u>Limits and Retentions</u>
<u>Non-Marine Proportional Reinsurance</u> <u>Fine Arts & Allied Risk Coverage</u>	77.67% quota share on all policies subject

100% authorized	to a maximum limit of $22,500,000 any one policy.
Excess of Loss Reinsurance:	
Property and Casualty (3 layers) 100% authorized	Exhibit A – Multiple Line Coverage $875,000 in excess of $125,000 each loss on any one risk as respects property business and one or more losses out of any occurrence as respects casualty business. Covers property and casualty business including commercial umbrella & commercial following form issued by Anfield Insurance Services, Inc.. Exhibit B – Property And Casualty Clash Coverage $4,000,000 in excess of $1,000,000 each loss on any one risk as respects Property Business, and as a result of one or more losses arising out of any occurrence as respects casualty business. Covers casualty business and property business issued by Anfield Insurance Services, Inc., or Triesco Insurance Services, Exhibit C – Casualty Business Coverage $900,000 in excess of $100,000 of one or more losses arising out of any Occurrence. Covers casualty business issued by Triesco Insurance Services,
Property 100% authorized	$4,000,000 in excess of $1,000,000 net loss of each risk. Property business written by Anfield and Triesco Insurance Services on risks located in the States of California, Oregon and Washington.

Type of Contracts	Limits and Retention
Commercial General Liability 100% authorized	Exhibit A – Commercial umbrella quota share $400,000 in excess of $1,600,000 net

loss each occurrence, each policy. Covers Commercial Umbrella, Commercial Following Form Excess, and Primary Commercial General Liability Business written by Anfield Insurance Services.

Exhibit B – Commercial Umbrella Excess of Loss and Exhibit C – Primary Commercial General Liability Contributing Excess of Loss $3,000,000 in excess of $2,000,000 net loss each occurrence, each policy. Covers commercial umbrella, commercial following form excess, and primary commercial general liability business written by Anfield Insurance Services.

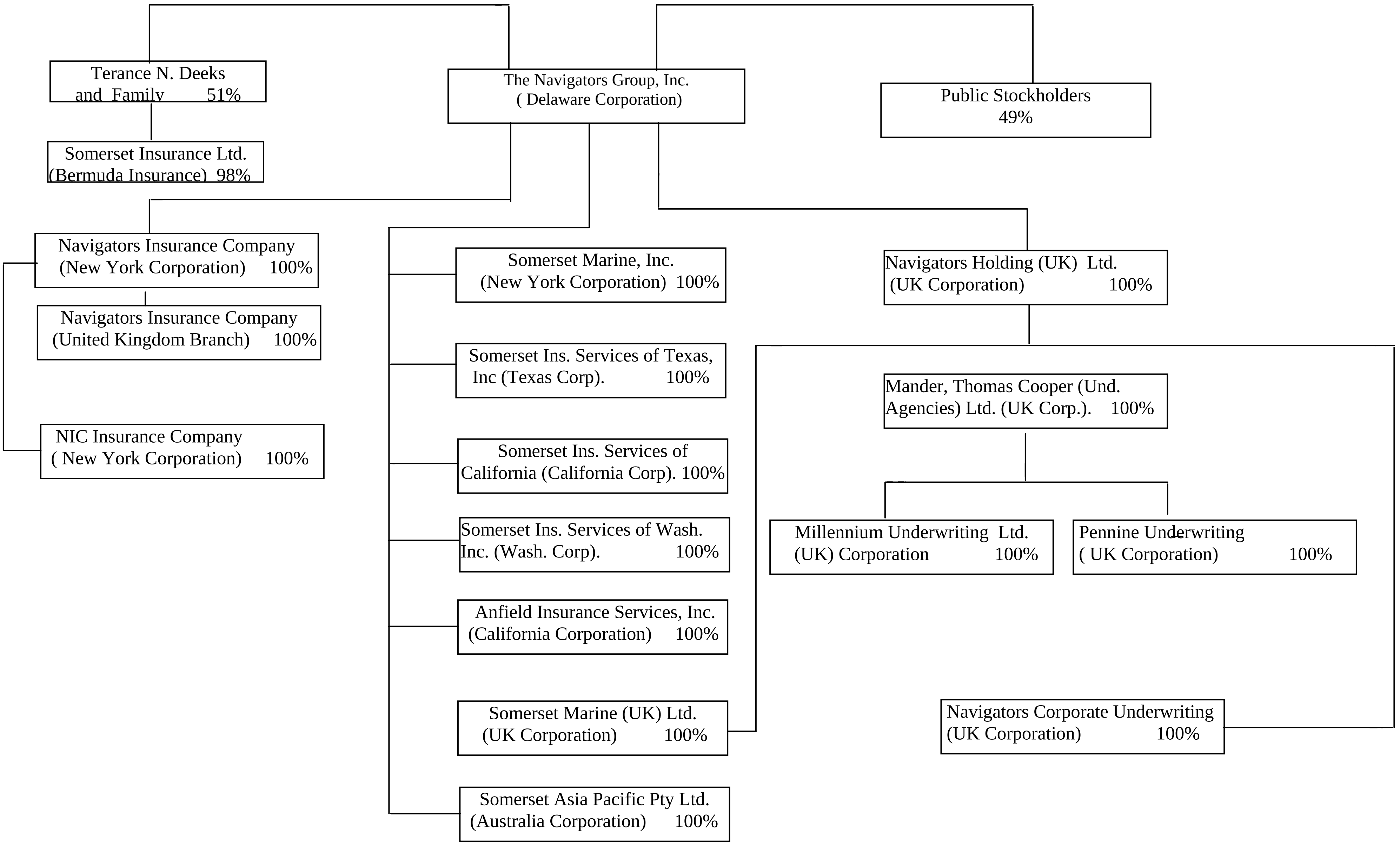
The Company's non-marine business consists of property business with limits under $1,000,000, and all casualty business produced by Anfield Insurance Services, Inc. ("Anfield").

In addition to the above coverages, the Somerset Agencies occasionally obtain facultative reinsurance for policies with limits in excess of the Company's capacity for a specific line of business.

Additionally, the Somerset Agencies entered into a reinstatement premium reinsurance program on behalf of the pool members, which reimburses the pool members for any premiums paid to reinstate coverage after reinsurance treaty limits are exhausted.

D. Holding Company System

The Company is a wholly-owned subsidiary of the Navigators Group, Inc., a publicly traded holding company domiciled in the State of Delaware, which is 51% owned by Terence N. Deeks and family. Mr. Deeks has been deemed to be the ultimate controlling person, as set forth in Section 1501 of the New York Insurance Law. The following is a chart of the holding company system as reported by the Company at December 31, 2000:



Terance N. Deeks and Family 51%
The Navigators Group, Inc. (Delaware Corporation)
Public Stockholders 49%
Somerset Insurance Ltd. (Bermuda Insurance) 98%
Navigators Insurance Company (New York Corporation) 100%
Navigators Insurance Company (United Kingdom Branch) 100%
NIC Insurance Company (New York Corporation) 100%
Somerset Marine, Inc. (New York Corporation) 100%
Somerset Ins. Services of Texas, Inc (Texas Corp). 100%
Somerset Ins. Services of California (California Corp). 100%
Somerset Ins. Services of Wash. Inc. (Wash. Corp). 100%
Anfield Insurance Services, Inc. (California Corporation) 100%
Somerset Marine (UK) Ltd. (UK Corporation) 100%
Somerset Asia Pacific Pty Ltd. (Australia Corporation) 100%
Navigators Holding (UK) Ltd. (UK Corporation) 100%
Mander, Thomas Cooper (Und. Agencies) Ltd. (UK Corp.). 100%
Millennium Underwriting Ltd. (UK) Corporation 100%
Pennine Underwriting (UK Corporation) 100%
Navigators Corporate Underwriting (UK Corporation) 100%

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 except for the 2000 statement. Pursuant to Part 80-1.4 of New York Regulation 52, all controlled insurers are required to file an annual holding company registration statement (Form HC-1) within 120 days following the end of its ultimate holding company's fiscal year, including an audited consolidated balance sheet and related consolidated statements of income and surplus for the ultimate holding company and each significant person within the holding company system. The Company did not file an audited consolidated balance sheet as of December 31, 2000, for the ultimate holding person until June 7, 2001. It is recommended that the Company file all of the required parts of its annual holding company registration statements in a timely manner pursuant to the provisions of Part 80-1.4 of Department Regulation 52.

The Company has entered into various agreements with other members of its holding company system, as follows:

1. Underwriting and Management Agreements

At December 31, 2000, Navigators participated in the following management and underwriting agreements with affiliated entities:

a. Somerset Agencies

Effective January 1, 1998, the Company entered into an underwriting and management agreement with the Somerset Agencies. The Somerset Agencies consist of the following entities: Somerset Marine, Inc., Somerset Insurance Services of California, Inc., Somerset Insurance Services of Texas, Inc., Somerset Insurance Services of Washington, Inc., Somerset Asia Pacific Pty Ltd., and Somerset Marine (UK) Ltd.. They collectively are underwriting managers for its ocean marine and commercial lines of business or reinsurance.

The Somerset Agencies are the exclusive agents for the Company. Pursuant to the terms of this agreement, the Somerset Agencies perform all administrative and operational duties of the Company, including underwriting, claims handling and premium collection for all business written by the Company. The Company also appointed the Somerset Agencies to act as its legal representative and true and lawful attorney on the Company's behalf in procuring, underwriting and servicing contracts of treaty reinsurance.

This agreement was submitted to this Department pursuant to the provisions of Section 1505(d)(3) of the New York Insurance Law and was found to be non-objectionable.

Based on the volume of gross written premiums produced by the Somerset Agencies, the Company has been deemed a producer-controlled insurer pursuant to the provisions of New York Regulation 52-A. A review of the underwriting management agreement with the Somerset Agencies indicated that the agreement did not include the required provision set forth in Part 80-2.2(b)(4)(ix) of New York Regulation 52-A, which states:

> "The controlling producer may negotiate but shall not bind reinsurance on behalf of the controlled insurer on business the controlling producer places with the controlled insurer."

It is recommended that the Company amend its underwriting management agreement with the Somerset Agencies to incorporate the missing required provision as specified in Part 80-2.2(b)(4) of Department Regulation 52-A.

b. <u>Anfield Insurance Services Incorporated</u>

Effective January 1, 1995, the Company was a party to an underwriting management agreement with Anfield Insurance Services Incorporated ("Anfield"), whereby Anfield is a non-marine underwriting agency, which is based in San Francisco. This agency specializes in underwriting general liability coverage to small artisan and general contractors on the West Coast. On April 2, 1999, Anfield was purchased by the Navigators Group, Inc. and therefore became an affiliate of the Company. The Navigators Group, Inc did not submit this agreement to this Department upon the acquisition of Anfield.

Section 1505(d)(3) of the New York Insurance Law states

> "(d) The following transactions between a domestic controlled insurer and any person in its holding company system may not be entered into unless the insurer has notified the superintendent in writing of its intention to enter into any such transaction at least thirty days prior thereto, or such shorter period as he may permit, and he has not disapproved it within such period: ….. (3) rendering of services on a regular systematic basis….."

Upon the examiner's request, the Company submitted the underwriting management agreement to this Department and it was non-disapproved by letter dated July 19, 2002. It is recommended that the Company submit all underwriting agreements to this Department for our non-disapproval in a timely manner pursuant to the provisions of Section 1505(d)(3) of the New York Insurance Law.

It is noted that on April 25, 2001, Anfield changed its name to Navigators California Insurance Services, Inc.

2. Reinsurance Agreements with Affiliated Entities

The Company assumes 100% of the business written by NIC Insurance Company pursuant to a reinsurance agreement, as described in Section 2C herein. The reinsurance agreement was submitted to this Department and was non-disapproved pursuant to the provisions of Section 1505(d)(2) of the New York Insurance Law.

3. Tax Allocation Agreement ("Agreement")

Effective December 31, 1983, the Company has filed a consolidated federal income tax return with its parent, The Navigators Group, Inc. pursuant to a tax allocation agreement. The tax allocation agreement was submitted to this Department and was non-disapproved pursuant to the provisions of Section 1505(d) of the New York Insurance Law.

Effective January 2, 2000, the tax allocation agreement was amended to add the names of two affiliates; however, this amendment was not submitted to this Department for non-disapproval. Subsequent to the date of this examination, the Company submitted the amendment to the tax allocation agreement to this Department and it was non-disapproved by letter dated April 6, 2002. It is recommended that the Company submit all amendments to its inter-company agreements to this Department for our non-disapproval in a timely manner pursuant to the provisions of Section 1505(d) of the New York Insurance Law.

E. Electronic Data Processing

During the review of the Company's unearned premiums and incurred losses, it was noted that the Company could not provide supporting data for these items as of the examination date. The Company indicated that it was unable to recreate year-end 2000 unearned premiums and incurred losses due to the inability of the system to hold the calculation for incurred and earned and maintain the data going backwards. The Company is working on correcting this problem.

It is recommended that the Company modify its systems so that the detailed records that support annual statement balances can be recreated.

F. Accounts and Records

Agents' Balances

Included in the agents' balances account is a receivable from the Navigators Management Company, Inc. The examiner noted that $5,513,699 of the agents' balances account represents operating advances from the Company to its manager.

This amount should have been reflected as "Receivable from the parent/affiliate" since this balance represents cash flow between the Company and the service manager and not premiums in the course of collection.

It is recommended that, for future annual statement presentation, the Company appropriately report its affiliated operating advances and agents' balances accounts.

G. Significant Operating Ratios

The following ratios have been computed as of December 31, 2000, based upon the results of this examination:

Net premiums written in 2000 to surplus as regards policyholders	.45 to 1
Liabilities to liquid assets (cash and invested assets less investment in affiliates	74.0%
Premiums in course of collection to surplus as regards policyholders	12.0%

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 examination period from January 1, 1996 through December 31, 2000:

	Amounts	Ratios
Losses and loss adjustment expenses incurred	$170,670,674	63.36%
Other underwriting expenses incurred	91,816,642	34.09
Net underwriting loss	6,882,678	2.56
Premiums earned	$269,369,994	100.00%

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, 2000. It is the same as the balance sheet filed by the Company.

Assets	Ledger Assets	Non-Ledger Assets	Not-Admitted Assets	Admitted Assets
Bonds	$199,683,832	$	$	$199,683,832
Common stocks	19,980,643	8,745,720		28,726,363
Cash and short-term investments	16,905,720			16,905,720
Receivable for securities	1,800,000			1,800,000
Premiums and agents' balances in course of collection	7,532,244		4,064,780	3,467,464
Premiums, agents' balances and installments booked but deferred and not yet due	8,634,539			8,634,539
Reinsurance recoverable on loss and loss adjustment expenses	12,922,240			12,922,240
Interest, dividends and real estate income due and accrued		2,723,226		2,723,226
Receivable from parent, subsidiaries and affiliates	52,319			52,319
Other assets	181,730			181,730
Prepaid expenses	99,906		99,906	
Total assets	$267,793,173	$11,468,946	$4,164,686	$275,097,433

Liabilities		Examination
Losses		$105,867,251
Loss adjustment expenses		7,968,503
Contingent commissions and other similar charges		824,342
Other expenses		776,685
Taxes, licenses and fees		694,971
Federal and foreign income taxes		2,511,684
Unearned premiums		25,959,759
Provision for reinsurance		14,579,000
Other payables		35,130
Retroactive reinsurance reserve		1,238,569
Total liabilities		$160,455,894
Surplus and Other Funds		
Common capital stock	$5,000,000	
Gross paid in and contributed surplus	46,122,108	
Unassigned funds (surplus)	63,519,431	
Surplus as regards policyholders		114,641,539
Total liabilities and surplus		$275,097,433

Note: The Internal Revenue Service has completed its audits of the Company's consolidated Federal Income Tax returns through tax year 1993. All material adjustments, if any, made subsequent to the date of examination and arising from said audits, are reflected in the financial statements included in this report. An audit covering tax year 1994 is currently under examination. The Internal Revenue Service has not yet begun to audit tax returns covering tax years 1995 through 2000. The examiner is unaware of any potential exposure of the Company to any tax assessment and no liability has been established herein relative to such contingency.

B. Underwriting and Investment Exhibit

Surplus as regards policyholders increased $29,107,017 during the period of January 1, 1996 through December 31, 2000, detailed as follows:

Statement of Income

Underwriting Income		
Premiums earned		$269,369,994
Deductions:		
Losses incurred	$143,870,100	
Loss adjustment expenses incurred	26,800,574	
Other underwriting expenses incurred	91,816,642	
Total underwriting deductions		262,487,316
Net underwriting gain		$6,882,678
Investment Income		
Net investment income earned	$64,469,188	
Net realized capital gains	5,366,182	
Net investment gain		69,835,370
Other Income		
Realized foreign exchange loss	$(172,414)	
Retroactive reinsurance gain	841,436	
Total other income		669,022
Net income before federal and foreign income taxes		$77,387,070
Federal and foreign income taxes incurred		13,891,582
Net income		$63,495,488

C. Capital and Surplus Account

	Gains in Surplus	Losses in Surplus	
Surplus as regards policyholders per report on examination as of December 31, 1995			$ 85,534,521
Net income	$63,495,488	$	
Net unrealized capital gains	5,025,222		
Change in non admitted assets		3,722,293	
Change in provision for reinsurance		11,191,400	
Dividends to stockholders		24,500,000	
Total gains and losses	$68,520,710	$39,413,693	
Net increase in surplus as regards policyholders			29,107,017
Surplus as regards policyholders per report on examination as of December 31, 2000			$114,641,538

4. LOSSES AND LOSS ADJUSTMENT EXPENSES

The examination liabilities of $105,867,251 and $7,968,503 are the same as the amounts reported by the Company in its filed annual statement as of December 31, 2000. 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.

5. PROVISION FOR REINSURANCE

The examination liability of $14,579,000 for the captioned item is the same as the amount reported by the Company in its filed annual statement as of December 31, 2000.

A. <u>Letters of Credit</u>

The Somerset Companies maintain approximately one thousand letters of credit, which fund reinsurance recoverable balances due from unauthorized reinsurers to the pool members, including Navigators. As of December 31, 2000, Navigators portion of these letters of credit totaled approximately $65.6 million, of which, approximately $58.0 million was utilized to reduce the liability for provision for reinsurance.

Upon review of the letters of credit, it was noted that many of them include multiple applicants and beneficiaries, or indicate the beneficiary to be "Somerset Marine Incorporated ("Somerset Marine") on behalf of Navigators Insurance Company". For letters of credit with multiple beneficiaries, in the majority of instances, the amount of credit is allocated based on the percentage of the Company's pool participation. For the remainder of the letters of credit, the amount of credit is allocated based on the actual amount due to each beneficiary.

The inclusion of more than one entity as beneficiary or indicating the beneficiary as "Somerset Marine Incorporated on behalf of Navigators Insurance Company" is in violation of Parts 79.1(b) and 79.1(c) of Department Regulation 133, which define "beneficiary" and "clean and unconditional", respectively, as follows:

> "(b) Beneficiary means the insurer in favor of which the letter of credit or its confirmation is established and shall include any successor by operation of law of any named beneficiary including, without limitation, any liquidator, rehabilitator, receiver or conservator."

> "(c) Clean and unconditional letter of credit or clean and unconditional confirmation means a letter of credit or confirmation which:
> (1) makes no reference to any other agreement, document or entity; and
> (2) provides that a beneficiary need only draw a sight draft under the letter of credit or confirmation and present it to promptly obtain funds and that no other document need be presented".

The prior report on examination noted these violations and contained a recommendation that all letters of credit obtained by the Company comply with the provisions of Department Regulation 133. As of the current examination date, the Company had corrected some of the letters of credit and has continued correcting others through the date of this report, but has not corrected all letters of credit. The Company has indicated the following reasons for not fully complying with the prior recommendation:

1. The Company has been sending notices to all of its reinsurers, but has not yet received corrected letters of credit.

2. The Company indicated their belief that the letters of credit should be corrected going forward implying that the Department would grandfather the prior non-complying letters of credit. Due to the Evergreen clause, letters of credit automatically renew at the current terms unless specifically amended.

3. Some of the Company’s letters of credit are over-funded and the Company is reluctant to request a new letters of credit for a reduced amount.

4. The Company indicated their belief the prior report criticism was based upon multiple beneficiaries and that as long as there was a single beneficiary Somerset Marine on behalf of Navigators would be acceptable.

The total amount of the non-complying letters of credit as of December 31, 2000 and as of the date of this report was $55,812,484 and $31,190,709, respectively.

While it is noted that all letters of credit issued after the prior report on examination were in compliance with Department Regulation 133 as well as the Company's good faith efforts to correct its existing letters of credit, many of the letters of credit are still not in compliance with Regulation 133. It is recommended that the Company continue its efforts to amend all of its outstanding letters of credit to indicate the sole beneficiary as “Navigators Insurance Company” pursuant to the provisions of Department Regulation 133.

At a meeting held in this Department on September 20, 2002, regarding the Company's failure to fully comply with the recommendation on letters of credit contained in the prior report on examination, the Department expressed its concern regarding the Superintendent's ability, as liquidator or rehabilitator, to draw down the letters of credit in the event of the insolvency of the Navigators Group. In order to alleviate the Department's concerns, the Company proposed that the Department could be designated as an attorney-in-fact on the letters of credit. It is recommended that the Company formally submit its proposed solution regarding the Superintendent's ability, as liquidator or rehabilitator, to draw down on the letters of credit in the event of the insolvency of the Navigators Group to this Department for review.

B. Schedule F- Part - 4

The examination review of the captioned liability indicated that the Company did not age its reinsurance recoverables on paid losses based on the date of billing. The Company recorded all reinsurance recoverables as current on Schedule F – Part 4 in the filed annual statement for December 31, 2001. This is not in accordance with the guidelines set forth in the Annual Statement Instructions for Schedule F.

The Company explained this problem as being related to the inability of its new underwriting software to produce a proper aging for the 4th quarter of 2000. Subsequent to the examination period, the Company has correctly filled out its Schedule F – Part 4 in its 2001 annual statement.

The Company could not calculate and the examiner was unable to determine the impact of the improper aging of its reinsurance recoverables on the "Provision for reinsurance" at December 31, 2000. A review of the "Provision for reinsurance" as of December 31, 2001, indicated that the amount was properly stated for that year. Based on the level of overdue reinsurance recoverables at December 31, 2001, the examiner does not believe that proper aging of the Company's reinsurance recoverables would have had a material impact on the Company's surplus as of December 31, 2000.

It is recommended that the Company age its reinsurance recoverables in accordance with the guidelines set forth in the annual statement instructions for Schedule F.

C. Invalid Offsets

It was noted that the Company netted balances owed under assumed reinsurance agreements to offset balances receivable under ceded reinsurance contracts when calculating this liability. Assumed balances are not valid offsets, as the parties are acting in different capacities; therefore, no offset should be allowed. In order to reflect credit for cessions to unauthorized insurers, a domestic insurer must be holding appropriate collateral as set forth in Department Regulation 20.

It is recommended that Navigators not include assumed reinsurance losses as an offset to reinsurance recoverable in Schedule F, Part 5, Column 6.

D. Funds Held

It was also noted that the Company offset reinsurance recoverable in Schedule F, Part 5, Column 6 with funds held by its managing agent, Navigators Management Company. Navigators Management Company obtained these funds when it drew down on letters of credit from reinsurers. It then deposited the cash in a fiduciary account. This is an invalid offset, because for the Company to take credit for the funds held the Company has to have exclusive control of the funds. The managing agent is in control of the funds and the Company gave no indication that the funds were to be forwarded to it.

It is recommended, that in the future, that the Company obtain any funds held by its managing agent from draw downs on letters of credit and deposit them in its own account to receive the proper credit for reinsurance recoverable.

6. COMPLIANCE WITH PRIOR REPORT ON EXAMINATION

The prior report on examination contained twenty comments and recommendations (page numbers refer to the prior report on examination.) It is noted that the Company has not complied with three of these recommendations. As a result, similar recommendations are contained in this report:

ITEM		PAGE NO.
A.	Management	
i.	It is recommended that the Company comply with the provisions of Section 624 of the Business Corporation Law at all times.	5
	The Company has complied with this recommendation.	
ii.	It is recommended that the Company comply with the provisions of Section 325(a) of the New York Insurance Law.	5
	The Company has complied with this recommendation.	
iii.	It is recommended that corporate procedures be established so that all items of a material nature that affect the Company’s operation and financial condition are presented to the board of directors for its consideration and review.	5-6
	The Company has complied with this recommendation.	
B.	Reinsurance	
i.	It is recommended that the Company amend the pooling agreement to reflect the name change of Pilot to NIC Insurance Company.	9
	The Company has complied with this recommendation.	

ITEM		PAGE NO.
ii.	It is recommended that formal reinsurance agreements be entered into between the Company and all other pool participants that conform to the requirements of the New York Insurance Law and standard insurance industry practices. The Company has not complied with this recommendation. As a result, a similar recommendation is contained in this report.	10-11
iii.	It is recommended that the actual participants to the reinsurance agreements be identified, and their percentage of participation defined in all reinsurance contracts entered into by the Somerset Companies for the benefit of the pool members. The Company has complied with this recommendation.	11
iv.	It is recommended that the Company make a conscientious effort to obtain finalized contracts in accordance with the guidelines set forth in Chapter 22 of the NAIC's, "Accounting Practices and Procedures Manual." The Company has complied with this recommendation.	20
C.	<u>Holding Company System</u>	
i.	It is recommended that the Company comply with the provisions of Section 1411(a) of the New York Insurance Law at all times. The Company has complied with this recommendation.	23
ii.	It is recommended that the Company make its Regulation 52 filings in a timely manner. The Company has not complied with this recommendation. As a result, a similar recommendation is contained in this report.	23
iii.	It is recommended that the Company file all addenda to its underwriting agreements with affiliate companies as required by statute. The Company has complied with this recommendation.	26
iv.	It is recommended that all underwriting management agreements contain full and complete descriptions of the amount of compensation payable to any producer. The Company has partially complied with this recommendation. A similar recommendation is contained in this report.	26 – 27

ITEM		PAGE NO.
v.	It is recommended that the Company comply with all provisions of Department Regulation 52-A and Section 1505(d)(3) of the New York Insurance Law.	27
	The Company has not complied with this recommendation. A similar recommendation can be found in this report on examination	
vi.	It is recommended that the reinsurance agreement between the Company and RECO be filed with this Department as required by Section 1505(d)(2) of the New York Insurance Law.	27
	The Company has complied with this recommendation.	
D.	<u>Abandoned Property Law</u>	
	It is recommended that, in the future, the Company comply with the provisions of Section 1316 of the New York Abandoned Property Law and file the report that is mandated by such law.	28
	The Company has complied with this recommendation.	
E.	<u>Premiums Written</u>	
	It is recommended that Company utilize an accrual method for premium accounting in order to provide for all risks bound as of any statement date.	28
	The Company has complied with this recommendation.	

7. SUMMARY OF COMMENTS AND RECOMMENDATIONS

ITEM		PAGE NO.
A.	Territory and Plan of Operation	
	It is recommended that the Company comply with the NAIC instructions to the annual statement and list in Schedule T each alien jurisdiction.	6
B.	Holding Company System	
i.	It is recommended that the Company file all of the required parts of its annual holding company registration statements in a timely manner pursuant to the provisions of Part 80-1.4 of Department Regulation 52.	15
ii.	It is recommended that the Company amend its underwriting management agreement and incorporate the missing required provision as specified in Department Regulation 52-A.	16
iii.	It is recommended that the Company comply with the provisions of Section 1505(d)(3) of the New York Insurance Law and file its underwriting agreement with affiliates on a timely basis.	17
iv.	It is recommended that the Company submit all amendments to its inter-company agreements to this Department for our non-disapproval in a timely manner pursuant to the provisions of Section 1505(d) of the New York Insurance Law.	18
v.	It is recommended that the Company modify its systems so that the detailed records that support annual statements balances can be recreated..	18
C.	Accounts and Records	
	It is recommended that, for future annual statement presentation, the Company appropriately report its affiliated operating advances and agents’ balances accounts.	19
	It is recommended that, for future annual statement presentation, the Company appropriately report its affiliated operating advances and agents’ balances accounts.	19

ITEM		PAGE NO.
D.	Provision for Reinsurance	
i.	It is recommended that the Company continue its efforts to amend all of its outstanding letters of credit to indicate the sole beneficiary as "Navigators Insurance Company" pursuant to the provisions of Department Regulation 133.	26
ii.	It is recommended that the Company formally submit its proposed solution regarding the Superintendent's ability as liquidator or rehabilitation to draw down on the letters of credit in the event of the insolvency of the Navigators Group to the Department for review.	27
iii.	It is recommended that the Company age its reinsurance recoverables in accordance with the guidelines set forth in the annual statement instructions for Schedule F.	28
iv.	It is recommended that Navigators not include assumed reinsurance losses as an offset to reinsurance recoverable in Schedule F, Part 5, Column 6.	28
v.	It is recommended, that in the future, that the Company obtain any funds held by its managing agent from draw downs on letters of credit and deposit them in its own account to receive the proper credit for reinsurance recoverable.	29

Respectfully submitted,

_________/S/______________
Erwin Roca,
Senior Insurance Examiner

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

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

_______/S/_____________
Erwin Roca

Subscribed and sworn to before me

this ______day of ____________________2003.

Appointment No. 21803

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:*

ERWIN ROCA

as proper person to examine into the affairs of the

NAVIGATORS 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 27th *day of* November 2001

GREGORY V. SERIO
Superintendent of Insurance